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The role of the Central Bank of Sri Lanka within the Doctrine of Public Trust



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Introduction

The recent macroeconomic turbulence encountered by Sri Lanka in 2021/2022 is the worst of that kind since independence. The Country faced its deepest economic catastrophe during the said period triggered by imprudent fiscal and monetary policies, subsequently elevated to social and political unrest.¹ Despite policy measures taken by the Central Bank and the then political regime to resolve the crisis were not properly worked out and finally, the country once again had to seek assistance from the IMF.

During the crisis, there was a huge outcry from the general public that the State and its other organs have failed and/or been negligent to perform their duties in the interest of the country. Several social activists invoked the Fundamental Rights jurisdiction of the Supreme Court against the then Head of the State, Ministers of Finance, the Central Bank of Sri Lanka (Central Bank/CBSL) and high level State officials etc., alleging that their actions or omissions jointly and severally caused the current economic crisis infringing the Fundamental Rights of Sri Lankan citizens. The Supreme Court of Sri Lanka also held that the several respondents of such matters including the Central Bank of Sri Lanka, have breached the Public Trust reposed on them by the general public and thereby responsible

for violating Fundamental Rights of the citizens of the country.²

The objective of this Article is to morefully explain the Doctrine of Public Trust from a perspective of law, how it is reposed on the Central Bank as an apex public authority, why it was alleged that the Central Bank has breached the Public Trust and the role of the Central Bank upholding the Public Trust in the performance of its duties.

The Doctrine of Public Trust as a global phenomenon

The Doctrine of Public Trust has been developed from both the Roman Law and the English Law³. It appears that the said Doctrine has been developed and invoked mainly aiming at securing the natural resources in the respective jurisdictions. There is no doubt that the rapid development of technology, industrialization, growing population and discovery of new energy sources in the realm of globalization appear to have shocked the world ecosystem in an unprecedented manner. These

¹ <https://www.orfonline.org/research/sri-lankan-economy-crisis-consolidation-and-collaboration> accessed on 26.03.2025, In June 2022, the United Nations warned of a potential "full-blown humanitarian emergency" in Sri Lanka, calling for USD 47 million in aid for the most vulnerable populations, depicting the severe hardships encountered by the people for no reason.

² Vide SC judgement in SC FR 195/2022 and SC FR 212/2022 in Sri Lanka

³ Justinian the Great was the emperor ruled in Eastern Roman centred in Constantinople during 527-565AD. Under his famous Code called Justinian Code, Justinian codified natural resources like air, sea, water falls, running water etc., cannot be held in private and but commonly dedicated for the interest of the general public; whereas under the English Law, the concept of "Trust" stemmed from the notion of equity and in early judicial rulings, the House of Lords has held that the bed of all navigable rivers here the tide flows, and all estuaries or arms of the sea, is by law, vested in the crown. But this ownership of the crown is for the benefit of the subject.

shocks have caused a lot of environmental and economic issues across the globe such as pollution, deforestation, flood, and frequent climate changes etc. Thus, the Doctrine of Public Trust has been used by the world community as a more effective and the most promising legal norm which imposes accountability upon Governments to preserve the country's environment in the sole interest of the citizens.⁴

Especially, under the judicial activism in USA, India and countries like South Africa and Kenya, this Doctrine has been designated as a effective artillery to protect environment⁵. This Doctrine primarily rests on the principle that certain resources like air, sea, water and the forests have such a great importance to the people as a whole that it would be wholly unjustified to make them a subject of private ownership. The said resources being a gift of mother nature should be made freely available to everyone, irrespective of their status in life. The Doctrine enjoins upon the Government and its instrumentalities to protect the resources for the enjoyment of the general public. In *Waweru vs. Republic*⁶, the High Court of Kenya, whilst quoting the Indian, Pakistan and several other jurisdictional use of the Doctrine of Public Trust, has held that the Government has a fiduciary duty to protect the environment and natural resources for the benefit of the people.

The Doctrine of Public Trust promulgated in Sri Lanka

The Doctrine of Public Trust is not a new norm in Sri Lanka. The Doctrine has its roots from the arrival of Arhat Mahinda. The sermon by Arhat

Mahinda to King Devanampiyatissa, inter alia emphasizes that everyone, including birds and animals, have right to live, and the king, being the guardian of the earth, shall ensure their right to life and move anywhere of the world.⁷

From a perspective of law, the judicial rulings of the Superior courts in Sri Lanka has also used the Doctrine to protect the environment. In the landmark judgement delivered by the Supreme Court in *Bulankulama vs. Secretary, Ministry of Industrial Development*⁸, it was held that it is immoral or illegal for private parties to arrogate natural resources which provided by the nature and what is necessary for humans' health and happiness. Citing the decision of *Weeramantri J* in *International Court of Justice in Hungary*⁹ case, *Amarasinghe J* established that the State is the guardian who is required to exercise the power in Trust. In subsequent cases, it was held that the Doctrine of Public Trust shall require all organs of the State are required to ensure that all the natural resources are protected and preserved for the public benefit and the State shall consider the sustainable development, ... and use the Doctrine of Public Trust in making any decision relating to natural resources.¹⁰

Going beyond the boundaries of environmental protection, it is observed that Sri Lanka's judicious use of the Doctrine of Public Trust has in its own unique way it encapsulates a wide spectrum not confined to the environment. One can safely conclude that this unique position was heavily influenced by the historical teachings and the constitutional reference to the "power of the People" pronounced in Article 3 and Article 4 of the Constitution.¹¹

4 <http://ir.kdu.ac.lk>; "The Application of Public Trust Doctrine as a Mechanism to Ensure Environmental Protection by Means of Law: A Comparative Analysis between Sri Lankan and Indian Legal Context" p. 131, by GJHK Siriwardana Faculty of Law, General Sir John Kotelawala Defence University, Ratmalana, accessed on 26.03.2025

5 <https://www.lst.lk>; "Public Trust Doctrine as people's Sovereignty: a narrative beyond environmental protection" by Nayantha Wijesundera, accessed on 30.03.2025

6 Misc. civ appli 118 Of 2004, extracted from LST review, volume 24 issue 315 2014 and via <https://www.globalhealthrights.org>, accessed on 30.03.2025

7 Judicial Service Association of Sri Lanka Law Journal - (2016 Vol -IV) ISSN 2357-2884, "The Public Trust Doctrine"; Rajitha Perera Senior State Counsel of the Attorney General's Department p.03

8 2000 (3) S L R 243; also known as *Bulankulama* case.

9 *Hungary vs. Slovakia* [1997] ICJ Rep. 7

10 *Wattegedara Wijebanda v Conservator General of Forest and Others*, [2009] 1 SLR p.338;

11 Judicial Service Association of Sri Lanka Law Journal - (2016 Vol -IV) ISSN 2357-2884, p.07

Unlike in the case of United Kingdom, in Sri Lanka, the sovereignty is with the people¹². It is inalienable and includes powers of the Government, Fundamental Rights, and Franchise.¹³ The invocation of Sovereignty has been vested with the three main devices of the State, namely, the Legislature, Executive and the Judiciary. In *Re the 19th Amendment to the Constitution case*¹⁴, it was *inter alia* held that the power remains and continues to be reposed on the people who are sovereign and its exercise by the particular organ of government being its custodian is for the people. This case has built a strong nexus between the State power and the Doctrine of Public Trust. It envisions that the people are the true proprietors of the State power and the State only holds such power in trust for them.

From the inception of application the Doctrine, the Supreme Court of Sri Lanka has held that there is no notion of unfettered or absolute discretion. Whatever discretion given to public officers must be used having consideration to the Rule of Law and right to equality enshrined in Article 12 of the Constitution. The Supreme Court has further held that the State power conferred on such public officials solely to be held for the public good and held in trust for the public; to be exercised reasonably and in good faith and upon lawful and relevant grounds of public interest; and unfettered discretion is wholly inappropriate to a public authority, which possesses powers solely in order that it may use them for the public good.”¹⁵

Hence it is abundantly clear that in addition to ensuring environmental protection, the Sri Lankan judiciary has used the Doctrine of Public Trust as a tool to control exploitation of the State power, curtail arbitrary discretion exercised by the State officials, and thereby upholding the Rule of Law.

12 Article 3 and 4 of the Constitution and in the *Re 19th Amendment case* [2002] 3 SLR 85, the Supreme Court has held that such Articles shall be read together.

13 Article 3 of the Constitution 1978

14 [2002] 3 SLR 97

15 *De Silva vs. Athukorale* 1993 1 S L R 283; <https://www.lawnet.gov.lk>, accessed on 30.03.2025

Nexus between the Doctrine of Public Trust and the Central Bank of Sri Lanka

The nexus between the Doctrine of Public Trust and the Central Bank in view of the powers, duties and functions to be exercised, performed or discharged by the Central Bank as the apex regulatory authority of the financial system in Sri Lanka needs to be ascertained. During 2022, the Central Bank was subject to the scrutiny of the Supreme Court. A few social activists instituted two Fundamental Rights (FR) applications in the Supreme Court as public interest litigations against the Head of the State, Cabinet of Ministers, Senior State officials including the Secretary to the President and the Secretary to the Treasury, a few Governors of the Central Bank, then Monetary Board of the Central Bank¹⁶ and the appointed members thereof. Leave to proceed was granted against several respondents including the Monetary Board and the then Governors of the Central Bank.¹⁷

The Petitioners in both cases invited the Supreme Court to consider whether the impact of the economic crisis on the society resulted in the infringement of fundamental rights of the people and if so, whether any one or more of the respondents were responsible for such infringements due to their actions and / or inaction during the period under consideration, while holding office in executive and/or administrative branches of the Government by breach of public trust entrusted upon them. The Petitioners alleged that it is a series of decisions taken during the relevant period, including the decisions to revise taxes, artificial control of the exchange rate, failure to maintain official reserves leading to serious depletion of reserves, failure to seek assistance from the International Monetary Fund (IMF) in a timely manner, and the failure to make necessary adjustments to the interest rates, which were the main causes for the economic catastrophe ever faced by the country since its independence.

16 The Monetary Board of the CBSL no longer exists by the repeal of the Monetary Law Act, No. 5 of 1949 (as amended) upon the enactment of the CBSL Act.

17 SC FR 195/2022 and SC FR 212/2022

In the aforesaid FR applications, the Supreme Court inter alia considered the following, in respect of the conduct of the Monetary Board, its appointed members¹⁸ and the two former Governors of the Central Bank:

the complete silence maintained by the Monetary Board in regard to the recommendations made by special sub-committees of the Central Bank and senior officials thereof emphasising that seeking IMF assistance would be a credible anchor to redress the situation;...

the behaviour of the Monetary Board and some of the appointed members despite that there were reports confirming the continuous depletion of gross official reserves, the dire need to seek IMF assistance and advice the Government accordingly, and no consensus could be reached by the members. knowledge of the Members of the Monetary Board during the course of this period, on the critical situation that prevailed in the Gross Official Reserves and ...that they were also aware of the unlikelihood of receiving such inflows from other sources...the duty vested with the Monetary Board to make recommendations to the Minister of Finance on par value of the Sri Lanka Rupee under the Monetary Law Act, the duty to maintain the international stability of the Rupee ... and to adopt appropriate policies and remedial measures, when there is a potential threat to the international stability of Sri Lanka Rupee under the said Law, rather than merely submitting periodic reports to the Minister;

joint actions taken by the Ministry of Finance and CBSL in maintaining the exchange rate at around Rs. 200/- per USD, which mainly benefitted the importers. Interference of 38th respondent, with the functions of the Monetary Board / Central Bank without any authority whatsoever at a time the country was facing a major crisis ... in maintaining the exchange rate at Rs. 192/-;

the views expressed by the former Central Bank

¹⁸ Under the aforesaid FR applications, Leave to proceed was granted only against three members of the Monetary Board wherein Leave not granted against Mr. Sanjeeva Jayawardena P C and Dr. Ranee Jayamaha, former appointed members of the Monetary Board of the Central Bank.

Governor, the 29th respondent, when the Monetary Board floated the exchange rate with effect from 08.03.2022 that “trades may take place beyond the exchange rate stated by CBSL considering the greater flexibility that has been permitted”, that triggered the sudden depreciation of the rupee between 225 to 364 (buying rate) and 229 to 377 (selling rate);

The inability of the Monetary Board to use the “exchange rate” as one such instrument given by the statute and that the exchange rate is fixed by moral suasion, with hardly any transactions taking place at that rate, causing the CBSL reserves to a negative level.

Considering the above, the Supreme Court unveiled its ruling in the aforesaid FR applications and held that the continued reluctance for a specific recommendation to the Government to seek assistance from the IMF by the majority of the members of the Monetary Board in these circumstances, is a violation of Public Trust reposed on the Monetary Board as a collective body as well as on individual members who maintained such continued resistance despite severe depletion of gross official reserves in the absence of any viable alternative to overcome this predicament...

Considering the resignation of the 32nd respondent, an appointed member of the Monetary Board, immediately after the decision of the Monetary Board to recommend to the Government to seek IMF assistance, the Supreme Court emphasized that when one accepts public office, they should have the capacity to look at issues objectively and resolve them in the best interest of the people rather than being obsessed with their personal beliefs... and any prudent person who did not act arbitrarily would have foreseen the serious repercussions in the failure to act swiftly to remedy the situation. Thus, the Supreme Court held that it is apt to reiterate that the persons holding public office have a duty to ensure that they exercise due diligence

and discharge their duties and responsibilities reasonably and rationally without acting arbitrarily.

The Supreme Court expressed its displeasure on the omission of the Monetary Board for not taking for discussion any concern brought before the Board by the former Senior Deputy Governor in his note dated 04.04.2022 listing out the Board papers and submissions made to the Monetary Board since 11.11.2020 on ... the status of gross official reserves as it stood by October 2020, the probability of the reserves dropping to critical levels in 2021, the advantages of an IMF assisted programme and the sentiments of other funding agencies on the absence of such programme.

Considering that the Monetary Board has the statutory duty to take necessary initiatives regarding the par value and the exchange rate of the Sri Lanka Rupee and the power to determine international monetary policy, maintaining international stability of the Sri Lanka Rupee and to adopt necessary policies to cause remedial measures to remedy serious decline in the international reserves has failed to take meaningful measures in a timely manner. The Supreme Court held that it did not however, observe any proactive measure/s taken by the Monetary Board to the challenges it faced either in bolstering the foreign reserves or preserving the meagre foreign reserve the country had during the period in question. This was considered as an inaction on part of the Monetary Board amounting to a breach of the Public Trust reposed on the Monetary Board.

The Supreme Court held that the Public Trust is an inherent responsibility bestowed on all officers who exercise powers which emanate from the sovereignty of the People. Therefore, as public officers, the respondents were obliged, at all times, to act in a manner which honoured the trust reposed in them. Further, considering the sequence of events of the entire financial crisis, the Supreme Court stated Obiter that the Monetary Board had

succumbed to the dictates of officials who had no authority to intervene in the affairs of the Central Bank.

In sum, the Supreme Court in a divided bench, finally held that by the actions, omissions, decisions and conduct hereinbefore identified to have demonstrably contributed to the economic crisis and that some of the respondents¹⁹ including the Monetary Board, had violated the Public Trust reposed in them and we hold that they were in breach of the fundamental right to equal protection of the law ordained by Article 12(1) of the Constitution.

The above judgement of the Supreme Court amply explains as to how the Doctrine of Public Trust could be used by the judiciary to hold parties, whether natural or legal, responsible for actions, inactions, abuse of power, in the exercise/non-exercise of their statutory powers and/or discharge/non-discharge of their public duties reposed upon the general public, going beyond its original sphere of environmental protection.

However, this is not the very first instance where the decisions or actions of the Central Bank were challenged before the Supreme Court. History reveals that the Central Bank was exposed to several incidents which were largely detrimental to its autonomy, reputation and integrity. Involvement in impugned oil hedging transactions, Investment of official international reserve in Sovereign Bonds issued by the Government of Greece, Issuance of controversial Treasury Bonds in 2015, Investing Employees Provident Fund in unviable projects are some of the instances, which shall not be repeated by the incumbent Central Bank.

It is observed that the aforesaid Supreme Court judgement has also paved the way to the other judicial forums in diagnosing public bodies, public

19 the 2nd respondent (Mahinda Rajapaksa), 2A respondent (Basil Rajapaksa), 29th respondent (Aith Nivard Cabraal), 30th respondent (Prof. W.D.Lakshman), 31st respondent (Mr S.R.Attygalle), 32nd respondent (Mr. Samantha Kumarasinghe), 32A respondent (Mr. Gotabaya Rajapaksa) and 38th respondent (Dr.P.B.Jayasundra)

officials, and politicians those have breached the exceptional norms of the Doctrine of Public Trust and that several matters such as, procuring substandard medicines, alienation of State lands for individuals, deforestation for unlawful settlements, misappropriation of public funds etc., have been brought before competent courts of justice.

Lessons learned upon breaching the Doctrine of Public Trust reposed on the Central Bank

The Supreme Court judgement given in the aforesaid Fundamental Rights Applications SC FR 195/2022 and SC FR 212/2022 was a landmark ruling against the Central Bank and/or its officials, in many aspects. It paved the way to the Central Bank to realize that it shall no longer be subject to the fiscal dominance of any elected Government, in the performance of its duties, it has no autonomy to defend the decisions taken in the interest of the economy and the financial system stability, it shall significantly curtail the monetary financing provided to the Government inconsistent with its monetary policy and in ensuring statutory objectives. The above judicial ruling was one of the key reasons to expedite the enactment of the Central Bank of Sri Lanka Act, No. 16 of 2023 in 2023 (CBSL Act), providing effective solutions to many such concerns, from a perspective of law.

Under the CBSL Act, the Central Bank is revived as a body corporate with a separate legal personality, entrusted with the primary objective of securing domestic price stability and other statutory objective of securing financial system stability²⁰, introduced new monetary policy framework to maintain low and stable inflation, provided with a strong financial and administrative autonomy to take its policy decisions devoid of fiscal dominance²¹, prohibited

monetary financing the Government except for in exceptional circumstances²², limited credit operations only through State funds²³, increased transparency and accountability in every action taken by the Central Bank. Introduced several public disclosures to be made on the state of the economy, financial stability, audited financials etc.²⁴ In view of the new scheme of powers, duties and functions exercised, discharged and performed by the Central Bank under the CBSL Act, it is observed that there is no room for the Central Bank breaching the Public Trust reposed on it once again, unless a completely different approach is taken by the Bank to perform its duties, in spite of its statutory obligations.

Even though CBSL is a financially and administratively autonomous body, it is essentially a part of the Government. Whilst ensuring the administrative and financial autonomy to be secured, the CBSL Act requires that CBSL shall support the general economic policy framework of the Government without prejudice to its primary and other objectives envisaged under the CBSL Act.²⁵ It further requires that in pursuing the primary object of achieving and maintaining domestic price stability, the Central Bank shall take into account, inter alia, the stabilization of output towards its potential level. Some Economists expresses the view that these provisions again confers camouflaged obligation upon the Central Bank to consider the overall economic stability of the country, without literally limiting to achieving and maintaining the domestic and price stability.²⁶ Hence, there is a possibility of reposing a new

Bank has the administrative and financial autonomy and it shall not seek any instructions from any person other than a professional opinion in the performance of its duties. It has further imposed a prohibition that it shall not be subject to any influence of any person.

22 Section 86 of the CBSL Act

23 Section 87 of the CBSL Act

24 Sections 80, 70, and 99 of the CBSL Act

25 Sections 6 and 104 of the CBSL Act

26 According to Dr. H N Thenuwara, the latest changes to the Central Banking Act... the primary objective is to maintain domestic price stability, and it also recognizes the need to maintain potential output. Those two taken together adheres... that the Central Bank is obliged to maintain both economic and price stability; Economic Policy Lessons for a new Sri Lanka, Dr. H N Thenuwara, p. 64

20 In addition to the above, there are certain ancillary objectives entrusted upon CBSL as the macroprudential authority of the country to complement the securing of financial system stability under part X of the CBSL Act.

21 Generally, central banks are sui generis institutions, which performs specific duties towards the public mandated by law. The autonomy of central banks is a universal principal upheld by Sri Lankan Supreme Court in Somapala Pattividana vs. Monetary Board and others in 2002. And under section 5 of the CBSL Act, it has ensured that the Central

dimension of Public Trust upon the Central Bank going beyond the boundaries of its primary and other statutory objectives.

In addition, from a perspective of power planning, it is inevitable to keep in mind that whatever the powers, duties, functions and more particularly, the discretion to be exercised by CBSL is not unfettered or absolute and such powers, duties and functions shall necessarily be exercised, discharged or performed by CBSL in the interest of the general public of the country upholding the rule of law and right to equality enshrined in the Constitution. It is conceptually upheld that the role of central banks, decisions taken, powers exercised, duties performed by such banks shall be reasonable, non-arbitrary, transparent, and upholding its accountability to the general public.

The post crisis decisions taken by the Central Bank so far, clearly shows that the economy has been resurrecting from its ill effects and moving towards the recovery. It is observed that the legislature, has eventually put an effective attempt to mitigate the risks faced by the Central Bank, by providing a safer legal arena to perform its public duties upholding the public trust reposed on it under the CBSL Act. In such circumstances, as long as the Central Bank, its appointed members, senior management or its employees, singly or taken together, do not act arbitrarily, maliciously and/or capriciously, disregarding its public duties, there is a sound legal and political environment for CBSL to secure its position before the Court of Law, ensuring that it has duly upheld the Public Trust reposed on it.

Conclusion

2024 is a very significant year for Sri Lanka from a perspective of both the economic, social and political developments. The country was immune from its debt default status due to the IMF support

and the policy measures taken by the Government to redress the crisis. People of the country was able to execute their new social contract with the newly elected political regime and the new executive, who have unanimously and unequivocally vouched the nation that they would never breach the Public Trust reposed on them.

As the apex institution entrusted with achieving and maintaining the domestic price stability, take into account, inter alia, the stabilization of output towards its potential level, supporting the government's general economic policy framework, and ensuring the financial system stability along with the intermediate macroprudential objectives to avert systemic risk/s, Central Bank has a pivotal role to play in the interest of the general public of the country. This is where the Doctrine of Public Trust intrudes the sphere of the Central Bank.

Hence, it shall always be lawful for Central Bank to act in a fair, transparent and accountable manner in the exercise, discharge and perform its powers, functions and duties, keep in mind that it has been established to service the general public and there is a Public Trust invisibly reposed on it upholding the principles of the rule of law.

Writer concludes this writing by quoting a dicta made by Sripavan, C.J in *Tiran P.P. Alles vs N.K. Illangakoon*, Inspector General of Police on exercise of power/ discretion.

“It is now well settled that powers vested in the State, public officers and public authorities are not absolute or unfettered but are held in trust for the public to be used for the public benefit and not for improper purposes..., the exercise of that discretion would also be subject to Article 12 as well as the general principles governing the exercise of such discretion.”²⁷ (emphasis added)

27 SC FR 171/2015; <https://www.supremecourt.lk>, accessed on 06.04.2025

Perspectives on Sustainable Finance

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This article highlights major perspectives on sustainable finance. It includes updates of information on recent global sustainable debt issuance, how climate risks affect financial stability, specifics on transition finance in Asia, and green finance for Sri Lankan financial institutions. It also emphasizes the responsibility of all citizens to implement sustainable finance to support economic prosperity.

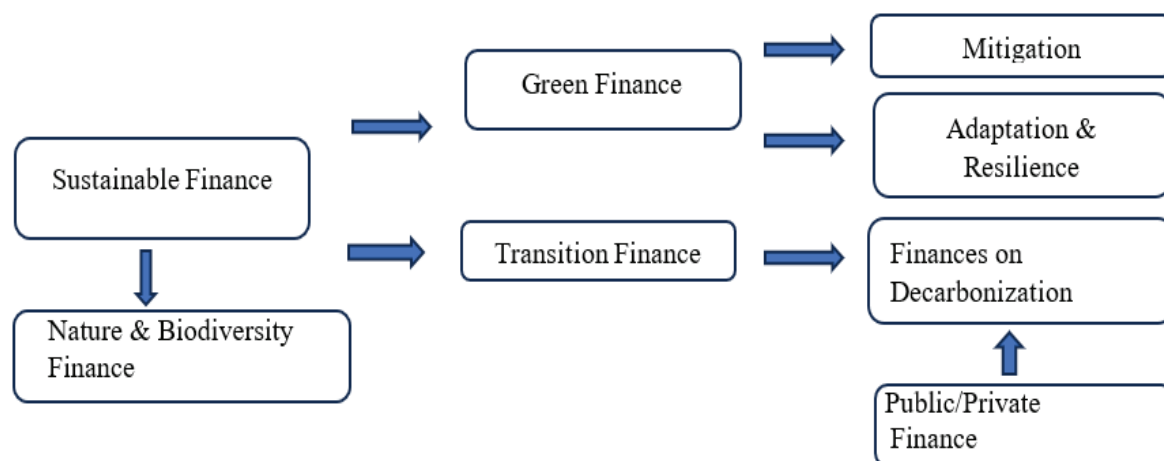
1. What is Sustainable Finance?

Finance reflects collective choices on environmental, social, and governance issues. However, sustainable finance signifies reallocating financial sector assets away from exposures to climate-related physical and transition risks and

towards low-carbon technologies aligned with sustainability outcomes, crucially a climate scenario that governments target (Ehlers et al., 2021).

There are three primary channels of sustainable finance: green finance, biodiversity finance, and transition finance. Green financing targets climate-neutral activities, and regulations specify the kinds of activities and technical standards for screening. Biodiversity finance involves raising and managing funds, as well as utilizing financial incentives, to promote and sustain the management of biodiversity. Transition financing refers to funding that is raised or implemented by corporations to carry out their net-zero transition, in compliance with the Paris Agreement's temperature goal and

Figure 1. Primary Channels of Sustainable Finance



based on reliable corporate climate transition plans (OECD, 2022).

2. Global Sustainable Debt Issuance

Sustainable finance and global sustainable debt issuance are connected because the debt market plays a vital role in funding sustainable projects and initiatives. Climate Finance Monitor highlights - IMF, there was very dynamic activity in the green bonds market and increased use of sustainability bonds in Europe, Asia, and worldwide in the 2023. There is a strong demand from investors for sovereign sustainable bonds in both developed and

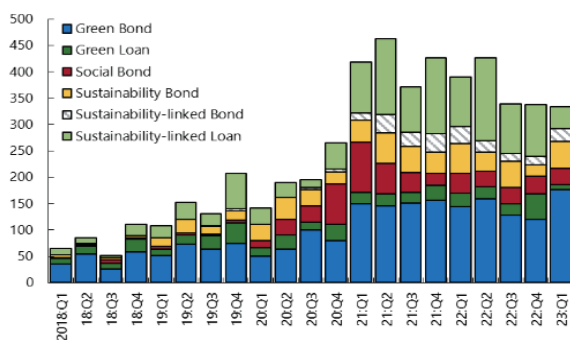
emerging markets. This trend reversal compared with 2022 issuance levels may reflect market participants' perceptions around greenwashing and the credibility of the asset class to drive companies to meet sustainability targets. However, the regional allocation held steady, with Europe and China accounting for 56 percent of the total, particularly when it came to sovereigns (Charts 1 and 2).

3. How Do Climate Risks Translate into Financial Stability Risks?

The climate risk and sustainable finance is deeply interconnected, as climate risk directly impacts

Charts Global Sustainable Debt Issuance -2023

1. Global Sustainable Debt Issuance by Instrument
(Billions of U.S. dollars; as of March 31, 2023)



2. Global Sustainable Debt Issuance by Region
(Billions of U.S. dollars; as of March 31, 2023)

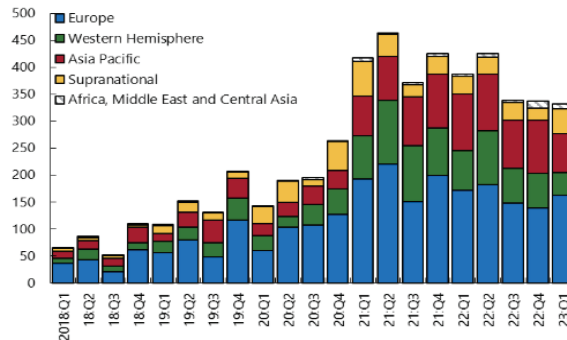
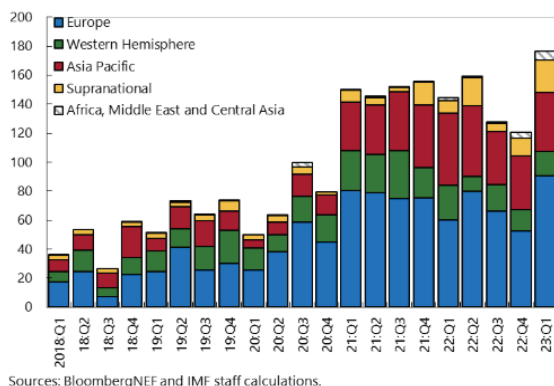
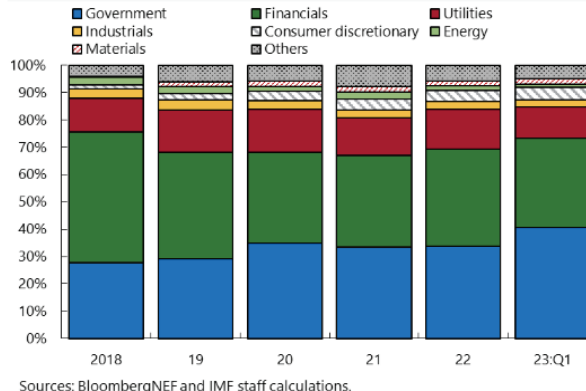


Chart 3 illustrates, that European issuers continued to dominate green bond issuance, while issuance in other regions was more subdued. Moreover, Chart 4 depicts the Government and Financials continued to lead green bond issuance.

3. Global Green Bond Issuance by Region
(Billions of U.S. dollars; as of March 31, 2023)



4. Global Green Bond Issuance Industry Breakdown
(In percent, as of March 31, 2023)

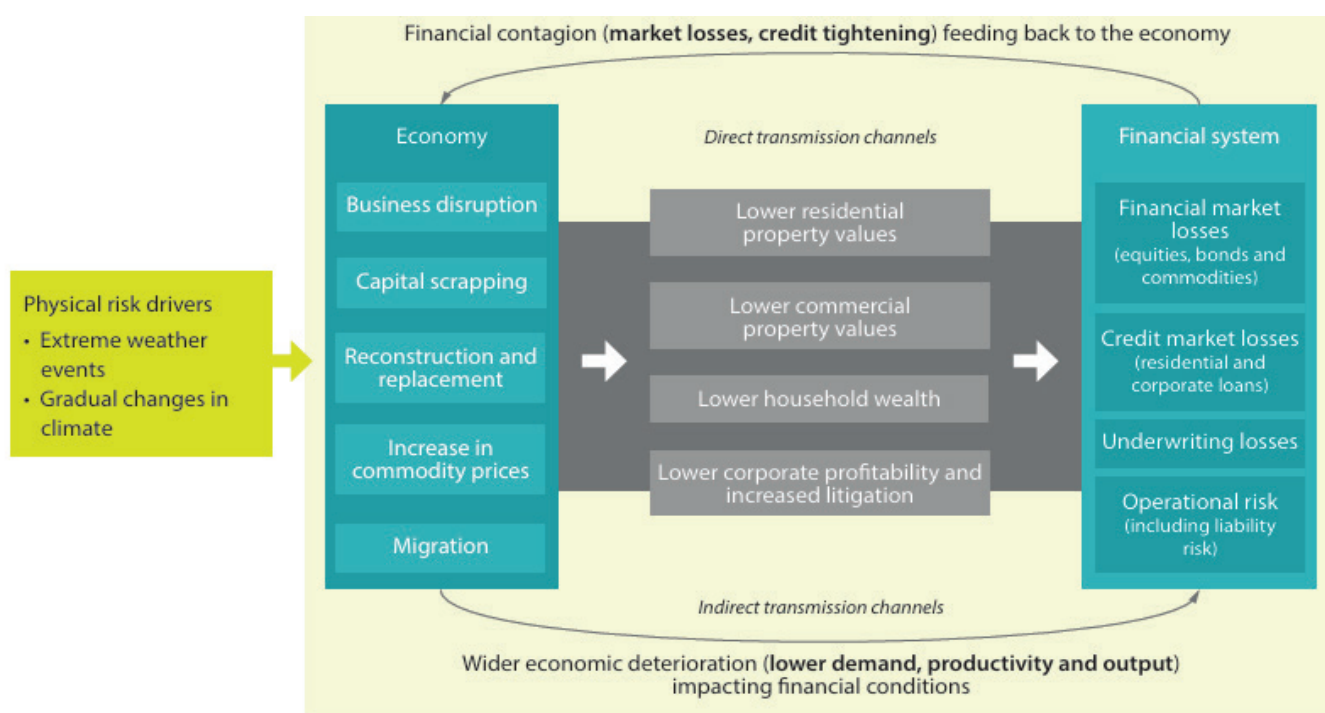


financial systems, while sustainable finance seeks to address and mitigate those risks. As highlighted by the Network for Greening the Financial System (NGFS) (April 2019) progress report, climate change may result in physical and transition risks that can have system-wide impacts on financial stability and might adversely affect macroeconomic conditions.

3.1 Understanding the possible impacts of physical risks

Physical impacts refer to the economic costs and financial losses arising from the growing frequency

directly through increased claims and their clients indirectly through higher premiums, if losses are insured. The financial burden of uninsured losses ultimately falls on individuals, businesses, and government budgets. Banks and other lenders may face greater credit risks if borrowers' ability to repay loans changes or if the value of their collateral declines. Investors and asset owners would be impacted by a shift in lenders predicted earnings, which would also be reflected in the financial markets.



Source: Network for Greening the Financial System (NGFS), 2019

and severity of extreme weather events related to climate change, such as heatwaves, floods, wildfires, storms, and landslides. They also include long-term, gradual climate shifts, like changes in precipitation patterns, increased weather variability, rising sea levels, higher average temperatures, and ocean acidification.

On the other hand, more frequent and severe weather incidents impact insurance companies

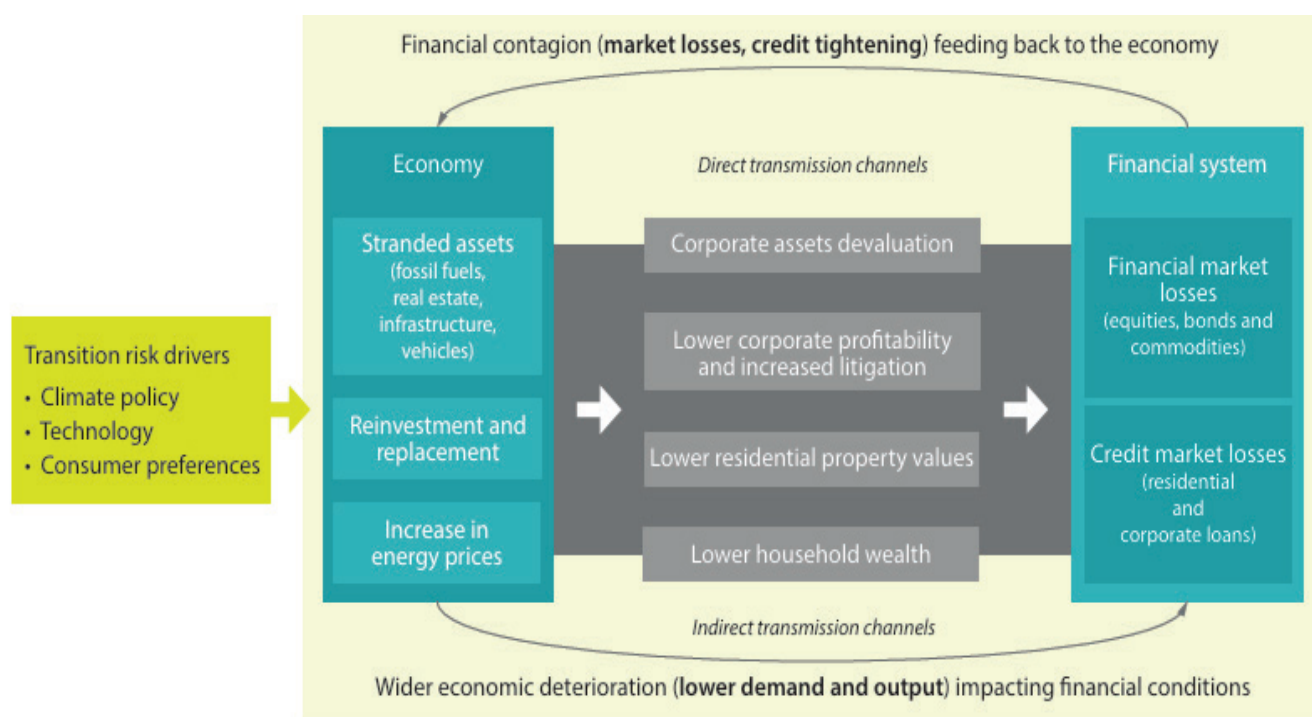
3.2 Understanding the possible impacts of transition risks

Transition impacts refer to the shift towards a low-carbon economy, with the goal of reaching “net zero” emissions to combat climate change. This transition will affect all sectors of the economy, influencing financial asset values. While urgent action is needed, a sudden transition could threaten financial stability and broader economic health.

These risks could impact key macroeconomic factors like growth, productivity, inflation, and energy prices, which are crucial for central banks' monetary policy goals.

Translating economic transition loss estimates into financial risks is difficult because macroeconomic models are typically designed for other purposes, like estimating the social cost of carbon or emissions targets. To link these models to financial portfolios, it requires comprehensive outputs at the firm, regional, and sectoral levels.

2050. Its demand for energy has increased due to economic growth, demographic expansion, and increasing urbanization. The 85 percent of Asia's energy comes from fossil fuels. Asia accounts for 50 percent of global greenhouse gas emissions, a third of which comes from coal-fired power plants. Coal accounts for almost 60 percent of electricity generation in Asia. In addition, the region's energy demand is expected to more than double by 2050. At least USD 1.1 trillion in annual investment is needed to meet the mitigation and adaptation needs of Asia's emerging economies and developing countries.



Source: Network for Greening the Financial System (NGFS), 2019

4. Transition Finance in Asia

The need for transition finance is particularly acute in Asia because its transition to a sustainable future is of global economic significance. The region is driving global growth, contributing around two-thirds of it last year. At the same time, Asia stands out to be one of the regions most exposed to physical climate risk. The loss in economic value for the region would be around 15-20 percent of GDP by

According to the IMF, countries face a climate financing gap of at least USD 800 billion. The mitigation gap is estimated at USD 600 billion per year, including infrastructure investment in clean energy sources. The adaptation gap is estimated to be around USD 200 billion per year. Furthermore, Asia and the Pacific are lagging on all 17 of the UN Sustainable Development Goals. To reduce emissions while achieving its development goals, Asia needs to accelerate and scale up innovative

financing solutions and instruments for its sustainable transformation.

4.1 Basics for Successful Transition Finance in Asia

To achieve an effective transition, all dimensions of the transition must be addressed. Economic growth and sustainability must be balanced. An effective transition is about making the whole economy more sustainable, not just growing the green economy. Investments in sustainable technologies and renewable energy are important. However, they represent less than 8 percent of the global economy. To get to net zero and a more sustainable world, we need to progressively make all sectors of the economy more sustainable. A just transition means delivering the socio-economic transformation required to address climate change, whilst reducing inequalities in the most affected regions and ensuring the costs and benefits of the transition are spread fairly. Gaps in the transition financing architecture must also be closed. The availability of good quality data, disclosure, taxonomies, and credible transition plans are helpful here. In addition, market barriers must be removed. For many emerging economies, access to international capital markets is often

a major challenge. Finally, successful transition financing requires coordination, cooperation, and partnerships.

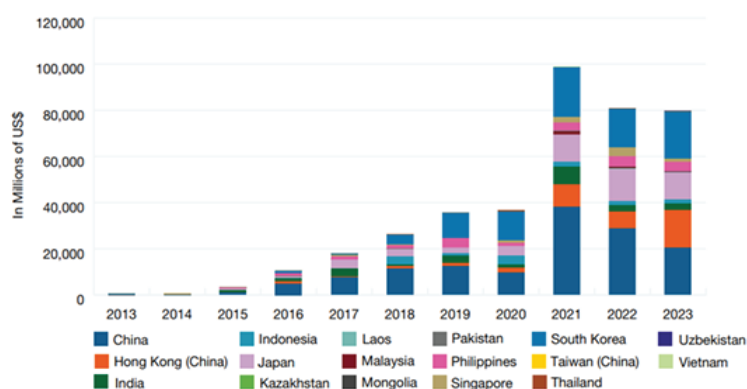
4.2 International Sustainable Bond Issuance in Asia

By looking at the Asian region especially (Chart 5), international issuance of sustainable bonds from Asian issuers grew to almost US\$100 billion in 2021 and then dropped to levels of about US\$80 billion in 2022 and 2023. Since 2015, Chinese issuers have taken a leading position in issuing international sustainable bonds, with their highest contribution at about 47 percent in 2016 and now stabilising at 26 percent in 2023. Meanwhile, Japan and Korea were also leading issuing countries, of which they combinedly contributed to an average of about 40 percent of annual issuance volume between 2019 and 2023, with Japan and Korea contributing to an average of about 13 percent and 26 percent, respectively. Issuance volume from Hong Kong in 2023 doubled year-over-year to about US\$16 billion.

In terms of issuer type, in the sustainable space, more than one-quarter of issuance volume originated from banks about 26 percent, followed by

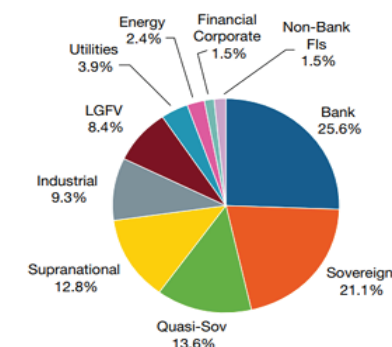
Chart 5: International Sustainable Bond Issuance in Asia

International Sustainable Bond Issuance in Asia – By Deal Nationality



Source: ICMA analysis using Dealogic data

Sector Breakdown of Asian G3 Sustainable Issuance



Source: ICMA, Covalent Capital

sovereign issuers about 21 percent. In comparison, looking at the total issuance, international agencies and banks both contributed about 20 percent of the total issuance individually. The overall market also enjoyed more diversified issuer types which are coming from sectors including materials, diversified, real estate, informational technology, and healthcare in 2023.

5. Green Finance for Sri Lankan Financial Institutions

In 2023, Sri Lanka became the 20th member of the International Platform for Sustainable Finance which is a forum established by the European Union for dialogue between policymakers with the overall aim of increasing the amount of private capital invested in sustainable investments.

5.1 Roadmap for Sustainable Finance in Sri Lanka

Sri Lanka's roadmap outlines plans to develop sustainable finance, offering guidance to financial institutions on managing environmental, social, and governance (ESG) risks in their financed projects. It aims to boost support for businesses that are environmentally sustainable, climate-friendly, and socially inclusive.

The specific objectives of the roadmap are to:

- (1) Bring policy cohesiveness across ministries, the Central Bank, other financial regulators, and financial sector participants and address specific ESG issues.
- (2) Enhance the resilience of financial institutions and enable them to grow and develop in a sustainable manner through effective ESG risk management.
- (3) Facilitate green/climate finance products and services innovation to mobilize predominantly private capital for sustainable investment,

making available the financial resources required for Sri Lanka to achieve the Sustainable Development Goals.

The roadmap focuses on banks and Non-Bank Financial Institutions regulated by the Central Bank of Sri Lanka (CBSL), but it also reflects the broader financial market's commitment to sustainability, including the banking, capital markets, and insurance sectors. Other financial institutions can use the roadmap to develop their own strategic sustainability initiatives.

5.2 Sri Lanka Green Finance Taxonomy

In 2022, in line with the Sustainable Finance Roadmap, CBSL launched the Sri Lanka Green Finance Taxonomy with the technical and financial support of the International Finance Corporation. The taxonomy is a classification system that identifies activities, assets, and revenue segments contributing to key sustainability goals, based on specified eligibility criteria. By following the taxonomy, the financial sector aims to prevent greenwashing. It focuses on three priority areas: climate mitigation, climate adaptation, and other green objectives. The taxonomy also highlights priority sectors, including agriculture, construction, tourism and recreation, electricity, gas, steam, air-conditioning supply, water supply, sewerage, and waste management.

6. Everyone Has a Role to Play

Investors need to make a demand for transition finance visible. This will encourage potential issuers to come to market with more deals. Issuers, be ambitious and explore the opportunities of transition financing through sustainable debt. They may be sitting on a pool of eligible sustainable assets and not know it.

Central Banks are given an advisory role in politics and are perceived as anchor investors for

further market growth. Promote global standards for transparent and consistent disclosures, while strengthening transition risk analyses and incorporating sustainability financial risks into prudential frameworks to enhance financial stability.

Banks, as market facilitators, are positioned to educate clients on transition finance opportunities and to promote and generate deal flow to satisfy unfulfilled investor demand. Live their new role as Sustainable Finance intermediary.

Regulators and Supervisors, make sure there are no obstacles to sustainable finance, market barriers, and no overregulation, which might lead to adverse market growth.

Governments and Policymakers, make national development and transition plans more sustainable and work more closely with the financial sector. Integrate transition targets into sustainability strategy and establish a sound transition governance framework for attracting private capital.

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The Role of Money Brokers in the Financial Market in Sri Lanka

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1. Introduction

The functionality of Money Brokers (MBs) in financial markets is vital, particularly in the context of price discovery mechanisms, in terms of interest rates, exchange rates, and asset prices. MBs have been active players in Sri Lanka's inter-bank call money market, repo market, foreign exchange market, as well as government securities market since the 1980s. This article discusses the role of money brokers in facilitating market liquidity, enhancing price transparency, and stabilizing the financial market by mitigating volatility through an assessment of prevailing literature, data, and market trends. Further, the article focuses on the significance of the money broker industry in Sri Lanka on the price discovery mechanism. Finally, the article elaborates on the existing regulatory framework and changes introduced under the enactment of the Central Bank of Sri Lanka Act No.16 of 2023 (CBA), with a view to strengthening the regulatory framework of MBs, together with the performance of MBs.

2. Role of Money Brokers in Price Discovery Mechanism

Money brokers are financial intermediaries who facilitate transactions between buyers and

sellers of money market (call and repo), foreign exchange, and government securities markets by way of connecting buyers and sellers. These brokers generally earn a brokerage fee for matching buyers and sellers for the deal. Money brokers, as intermediaries in the financial markets, play a crucial role in this process by facilitating transactions and influencing the supply and demand factors that drive price formation. Price discovery mechanism by money brokers is essential to the effective functioning of financial markets, particularly in sectors like foreign exchange (Forex) and money markets.¹ Money brokers act as intermediaries, connecting buyers and sellers with a view to the facilitation of transactions. Brokers ensure liquidity and transparency, allowing market prices to be determined based on the actual supply and demand in the market. In the money market, brokers help to determine interest rates for short-term money market transactions by connecting lenders and borrowers in the money market, with the bid and offer spread often serving as an indicator of market liquidity. In the forex market, brokers contribute to the price

¹ Price Discovery Mechanism refers to the process through which the price of a financial asset, such as foreign currency, securities, or short-term money market instruments, is established in a market.

discovery of the foreign exchange market by matching the requirements of counterparties, which determines the prevailing market price. Hicks (1990) emphasizes money broker role as intermediaries between buyers and sellers of short-term financial instruments (like foreign exchange, repurchase agreements, or short-term loans). Anand, and Subrahmanyam (2005) studied information and the intermediary and found that market intermediaries informed traders in electronic markets, and found that the intermediaries continue to play a significant role in price discovery, and they are more informed than their clients. Flood, Huisman, Kodeijk, and Mahieu, (1999) studied quote disclosure and price discovery in multiple-dealer financial markets and found that higher liquidity and lower price discovery of the more transparent market are the result of speculating brokers exploiting the lower search costs in this market. Dheerasinghe, (2019) emphasized that the money broker acts as a mediator to bring suppliers of funds (lenders) and users of funds (borrowers) together, enabling them to enter into a contract for money market transactions such as short-term loans, foreign exchange dealings, repurchase (Repo) and reverse repurchase (Reverse Repo) agreements etc. They arrange these transactions, particularly between corporate customers such as banks, primary dealers, discount houses, and dealers in government securities. Further, she explained that the money brokers do not themselves lend or borrow money. They work for a commission for arranging contracts, often for short-term loans on an overnight basis.

The price discovery mechanism is subject to a few factors that money brokers consider when facilitating transactions. One key element is

the order flow, where the flow of buy and sell transactions through a broker helps determine the prevailing market price. By matching transactions that reflect current requests, brokers contribute to the establishment of a fair market price for a particular segment. In addition, bid-ask spreads play a vital role in this process, with the difference between the price at which they buy (the bid price) and the price at which they sell (the ask price) identified as the bid-ask spread. The size of the bid-ask spread provides an understanding of market liquidity as a lower spread proposes a liquid, competitive market, which enables more accurate price discovery. However, a higher spread may indicate lower liquidity and higher transaction costs, possibly distorting the price formation mechanism. The above factors together help brokers maintain an efficient price discovery mechanism in financial markets.

3. Other Country Experience on the Role of Money Brokers

The money broking industry is a well-established sector, with active participation in many countries, ensuring the smooth functioning of short-term financial transactions. Regulatory oversight plays a crucial role in maintaining the integrity and stability of these operations. In India, money brokers facilitate short-term transactions between banks while adhering to full regulatory compliance under the supervision of the Reserve Bank of India (RBI). Similarly, in Pakistan, the Securities and Exchange Commission of Pakistan (SECP) ensures a sound regulatory environment for short-term lending and interbank transactions, overseeing the operations of money brokers. Singapore and Hong Kong both have dynamic

money markets, with money brokers playing a significant role in foreign exchange and short-term funding activities. In Singapore, the Monetary Authority of Singapore (MAS) supervises these operations, while in Hong Kong, the Hong Kong Monetary Authority (HKMA) provides the necessary regulatory framework. Taiwan's money broking activities, focused on short-term borrowing and lending between financial institutions, are regulated by the Central Bank of Taiwan. Similarly, Malaysia has a well-regulated money market under the oversight of Bank Negara Malaysia, with active participation from money brokers in facilitating transactions. In Brazil, the Central Bank of Brazil oversees money brokers involved in interbank transactions and short-term funding, ensuring a well-regulated money market. The United States, with its expansive financial markets, also boasts active money broking operations, governed by the Federal Reserve (FED), which supports interbank lending and short-term instruments. In Japan, the Bank of Japan regulates the money market, ensuring effective liquidity management, while in Australia, the Reserve Bank of Australia (RBA) supervises the country's financial markets, with money brokers playing an active role in liquidity management. Nepal has a developed financial market, with a fully regulated stock exchange and active forex trading, including licensed brokers and regulations for money broking activities.

In contrast, Nigeria's money broking sector remains underdeveloped, with limited participation and a regulatory framework. Uganda's financial sector is growing, particularly in digital finance, but the money broking sector is still in its nascent stages, lacking a clear regulatory framework. Thailand, although

focused on enhancing the competitiveness of its financial sector, is still in the process of developing its money broking sector, with ongoing efforts to improve its regulatory and operational frameworks.

4. Importance of Money Brokers in Price Discovery Mechanism

(i) Ensure Availability of Liquidity

Money brokers bridge the market by connecting counterparties such as banks and financial institutions that need capital with those who are looking to invest or lend. In markets with a liquidity shortage, the price discovery mechanism can become distorted due to large price volatility caused by limited transactions. Brokers help mitigate such occurrences by facilitating a greater volume of transactions, ensuring that prices reflect broader market sentiment rather than being skewed by a lack of participants.

(ii) Facilitating Transparency

Money brokers also play a vital role in improving market transparency. In markets like foreign exchange or short-term money markets, prices are often negotiated via brokers, who provide a platform for buyers and sellers to meet. The information provided by brokers on deal prices and deal volumes helps all market counterparties to understand the current market trends and behaviour, which, in turn, assists in accurate price discovery.

(iii) Influencing Spot and Forward Prices

Money brokers play a significant role in determining both spot and forward rates in the forex market. Spot rates are the immediate

exchange rates at which currencies can be traded, while forward prices are agreed-upon prices for future forex transactions. Money brokers help these transactions by matching buyers and sellers and ensuring that their transactions reflect the underlying supply and demand in the market. These prices established benchmarks that inform trading decisions in the wider market.

5. Challenges to Price Discovery by Money Brokers

Despite their vital role in facilitating the price discovery mechanism, money brokers face many challenges that can hinder the accuracy and efficiency of the process. Market fragmentation is one such challenge, as many platforms and brokers offering varying prices can create inconsistencies, making it difficult to set a united price for segments. Further, regulatory restraints can affect the functioning of brokers by restraining their activities or imposing trade implementation limitations, which can disrupt the flow of information and liquidity, ultimately damaging the price discovery mechanism. In addition, market manipulation by leading players, such as systematically important banks or financial institutions, can distort the price discovery mechanism if they leverage their positions to influence prices. Despite these challenges, money brokers play a vital role to the price discovery mechanism by providing liquidity and ensuring that financial instruments are priced in an efficient, transparent way.

6. Evolution of the Money Broking Industry in Sri Lanka

Before the establishment of the first money broking company in Sri Lanka in the early 1980s,

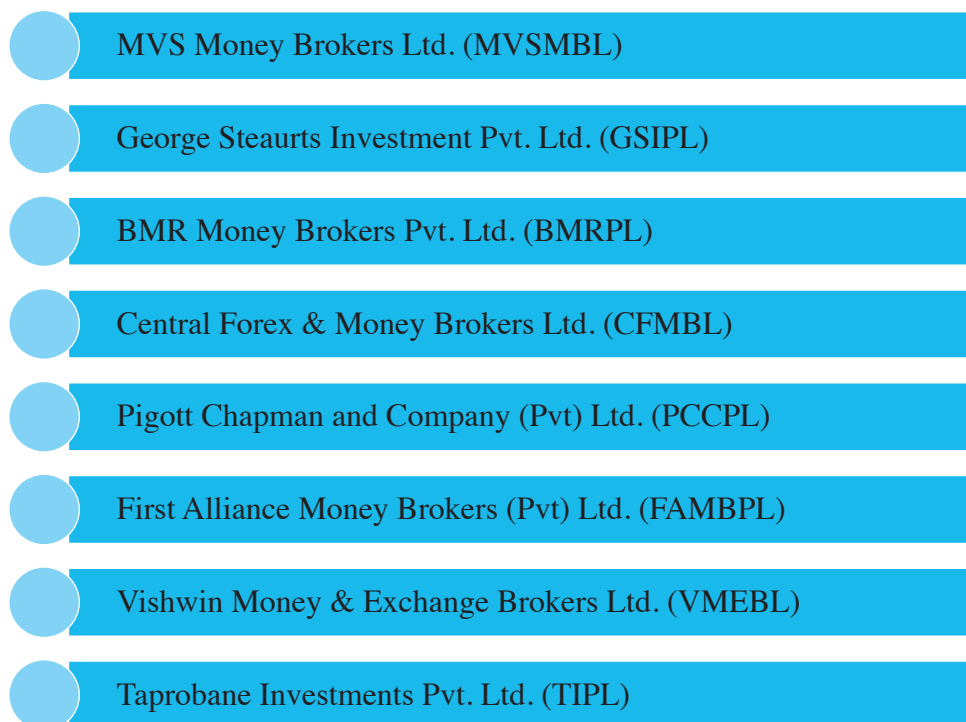
licensed commercial banks (LCBs) directly picked up foreign exchange-related transactions and adjusted their rupee liquidity positions via the requirement of borrowing and lending in the call money market. However, with the development in the financial sector, including the increase in the number of institutions, activities, new tools, and transaction volumes, the requirement for intermediaries such as money brokers (MBs) became essential. MBs played a vital role in facilitating more efficient foreign exchange-related transactions, money market transactions as well as government securities market transactions than what could be achieved through direct interactions between banks. MBs perform as intermediaries between lenders and borrowers, arranging contracts for short-term funds, foreign exchange-related transactions, and repurchase (Repo) transactions, particularly between corporate customers such as licensed commercial banks (LCBs), primary dealers, and dealers in government securities. The first money broking company in Sri Lanka, Bartleet, Macklai & Roy Ltd, was established in 1980 in collaboration with India. Since then, the Central Bank of Sri Lanka (CBSL) has supported the development of the money-broking business. The entry of money brokers in 1982 added a new dimension to market liquidity, information availability, transparency, and transaction ease². By 1984, seven more money broking firms had arrived on the market, many in collaboration with international firms. Although some companies have been discontinued, others have continued to operate, including George Steuart Financial Services Ltd., which resumed its business in

² 60th Anniversary Publication of Central Bank of Sri Lanka, Chapter 06, Surviving in White Waters - Stabilising Domestic Financial Markets

2005. Further, the SMB Money Broking (Pvt) Ltd., terminated their business operations from February 2025, and there are eight AMBs providing money-broking services in Sri Lanka by the end of June 2025.

this letter provided reassurance to the PIs engaged in inter-bank money market transactions. In 2012, there were nine MBs³ that had received “No Objection” letters from the CBSL. As these MBs operated as intermediaries, not acting as principals⁴ or conducting transactions

Chart 1: AMBs Operate in Sri Lanka as at end June 2025



Source: Central Bank of Sri Lanka

7. Evolution of Legal and Regulatory Framework of Money Broking Industry in Sri Lanka

The money broking industry has been operating since 1980, until the CBSL issued the Money Broking Regulation in 2013, it remained unregulated. Prior to 2013, CBSL addressed the needs of prospective MBs by issuing a “No Objection” letter, allowing them to conduct their business. Participatory Institutions (PIs), especially licensed commercial banks (LCBs), generally require this “No Objection” letter, as

on their own, and thus did not pose significant “systemic” risks to the inter-bank money and foreign exchange markets. As a result, it was not deemed necessary to subject them to a formal regulatory framework similar to that of authorized institutions. In addition to issuing the “No Objection” letters, the Central Bank monitored the activities of MBs by requiring

³ Eight companies incorporated under the Companies Act No. 7 of 2007 and one partnership

⁴ Not acting as principals means that the MBs act as intermediaries, connecting buyers and sellers without directly engaging in transactions or assuming ownership or risk. Since they don’t hold or trade assets themselves, they don’t create significant risks that could impact the stability of the financial system, especially in the inter-bank money and foreign exchange markets.

them to report annually on their performance, status, and financial statements. However, with CBSL's efforts to introduce regulations for the foreign exchange market, attention was drawn to the need for regulating money broking activities as well.

CBSL plays a critical role in maintaining financial stability and ensuring the smooth functioning of the financial system. The need for the CBSL to regulate AMBs is due to their significant influence on the price discovery process within money and foreign exchange markets. These markets are highly sensitive to fluctuations and disruptions, and AMBs act as intermediaries in these transactions, facilitating the buying and selling of call, repo, foreign exchange, and Treasury bills and other financial instruments. Without proper regulation, the activities of AMBs could introduce risks that might destabilize the markets, leading to volatility or even systemic crises. By issuing regulations under Section 10 (c) of the Monetary Law Act (MLA), the Monetary Board (MB) was empowered to set guidelines that ensure AMBs operate in a manner that is transparent, efficient, and aligned with the broader objectives of monetary policy and financial stability. This regulatory framework mitigated potential market disruptions, ensures the integrity of the financial system, and fosters a stable environment for both local and international investors. Ultimately, regulating AMBs is necessary to safeguard the financial system and ensure the smooth operation of the money and foreign exchange markets. Accordingly, several provisions in the MLA empowered the CBSL to regulate activities related to the CBSL and address potential threats to the financial system. Under Section 10 (c) of

the MLA, the Monetary Board was authorized to make rules and regulations deemed necessary for matters related to the exercise, discharge, or performance of the CBSL's powers, functions, and duties. Given the significant role MBs play in the price discovery mechanism within money and foreign exchange markets, and to reduce the risk of market disruptions caused by their involvement, the Monetary Board approved issuing regulations governing the activities of MBs under Section 10(c) of the MLA. Furthermore, with the enactment of the Central Bank of Sri Lanka Act (CBA) No. 16 of 2023, Authorized Money Brokers (AMBs) are now classified under Financial Institutions, thereby enhancing the regulatory framework governing their operations. This change strengthens the oversight and ensures that AMBs adhere to the established regulations, promoting greater compliance and accountability within the financial system.

8. Measures taken by the CBSL to Strengthen the Regulatory Framework for the Money Broker Industry in Sri Lanka

(i) Issuance of Money Broker Regulation No. 01 of 2013

Money Broking Regulation No. 01 of 2013 provides a comprehensive framework for the operation of money brokers, requiring them to obtain a license from CBSL to operate as a money broker. Further, with effect from 15 February 2013, money brokers are defined as Authorized Money Brokers (AMBs). This Regulation outlines the operational standards that brokers are required to follow, ensuring transparency, fair practices, and adherence to reporting requirements. It provides capital adequacy requirements to ensure brokers

maintain adequate financial strength. AMBs are also compulsory to implement effective risk management practices, monitor market risks, and maintain robust transaction records with regular reporting to CBSL. Further, this Regulation includes provisions for supervision, monitoring, and audits by the regulatory authority, along with payments for non-compliance, potential revocation of licenses. Overall, the regulation aims to ensure the integrity and stability of money broking activities in the market. Considering the various requirements, the Money Broking Regulation No. 01 of 2013 was amended in 2018 and 2019. Accordingly, currently prevailed the Money Broking Regulation No. 01 of 2018 and its subsequent amendments in 2019.

(ii) Issuance of Code of Conduct for AMBs

To enhance the market conduct and practices of AMBs, the CBSL introduced a code of conduct to all AMBs effective from November 2018. This code of conduct aims to ensure that AMBs operate with the highest standards of integrity and professionalism, aligning with international best practices. These initiatives are aimed at promoting the growth of the money broking industry by raising better mutual trust and confidence between AMBs and their clients.

(iii) Classification of Money Brokers under the Financial Institutions in Central Bank of Sri Lanka Act

Following the enactment of the Central Bank of Sri Lanka Act (CBA) No. 16 of 2023, any AMB holding a Certificate of Authorisation under the Money Broking Regulations was classified as a “Financial Institution” as of

14 September 2023. Consequently, all AMBs were directed to adhere to the requirements set forth in these Regulations.

9. Analysis of Money Broking Activities in Sri Lanka’s Financial Markets

Over the years, AMBs have contributed to the growth and development of Sri Lanka’s financial market, especially in handling foreign exchange-related transactions, and facilitating liquidity in the call and repo market while supporting government securities-related transactions. With the development of financial markets and growing demand for their services, AMBs continue to improve their contributions and extend their reach to a broader level of financial institutions, thereby promoting market efficiency and stability. As depicted in Figure 1, AMBs are active in the money market and domestic foreign exchange market, facilitating high-liquidity, short-maturity transactions such as call money, repo, and outright transactions, as well as foreign exchange transactions. The performance of AMBs across these segments has varied significantly between 2019 and 2024, influenced by market dynamics, economic challenges, and regulatory measures.

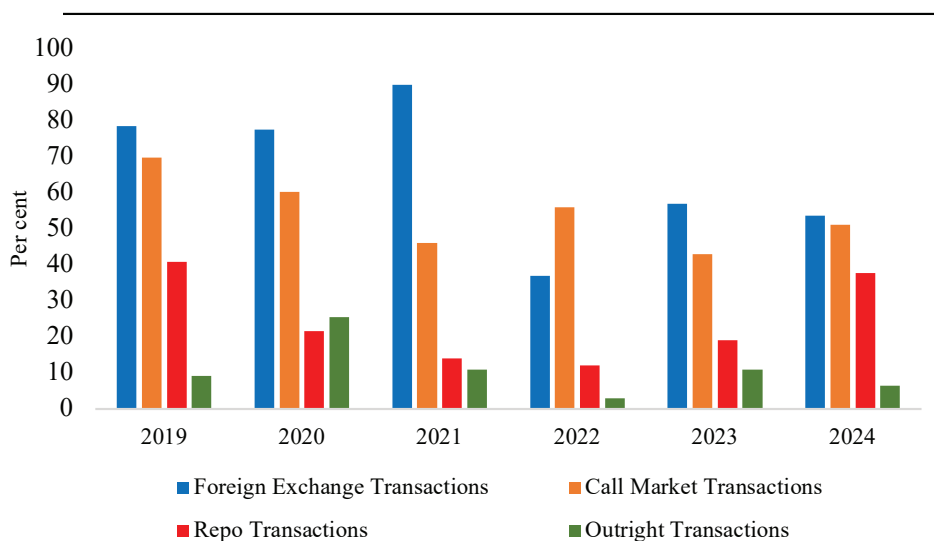
In recent years, the performance of AMBs in the foreign exchange, call money, and repo markets has seen significant fluctuations due to various market conditions and global events, particularly the COVID-19 pandemic. In the foreign exchange market, AMBs initially held a dominant share but experienced a decline during the pandemic as forex transactions slowed. While there was a brief recovery in subsequent years, their market share remained volatile, influenced by the overall market dynamics and changing transaction volumes. This trend was characterized by a sharp dip in 2022, followed

by a partial recovery in 2023, driven by a surge in forex swap transactions. However, by 2024, AMBs' share in the forex market experienced another slight decline. In the call money market, AMBs faced a similar trend, with their market share decreasing during the pandemic due to sluggish market behavior. Despite a drop in overall call money transactions in 2022, AMBs were able to maintain their intermediation services, resulting in a rebound in their market share. This recovery continued in 2024, driven by improved liquidity and greater involvement of state and foreign banks. The repo market

10. Conclusion

In conclusion, money brokers (MBs) play a crucial role in Sri Lanka's financial markets, significantly contributing to the price discovery mechanism, enhancing liquidity, transparency, and efficiency. By facilitating efficient transactions and reducing volatility, MBs help stabilize the market, particularly during times of economic uncertainty, mitigating systemic risks. The need for a robust regulatory framework has become increasingly important as the industry grows. The CBSL responded

Figure 1: Sectoral Composition of Money Broking Industry (2019 - 2024)



Source: Central Bank of Sri Lanka

saw AMBs facing significant challenges as their share dropped during the pandemic but gradually began to recover in 2023 and 2024. This recovery was driven by increased demand from domestic private banks and improved liquidity conditions in the market. Overall, while AMBs experienced a decline in market share during periods of economic uncertainty, they managed to recover in some markets due to an uptick in demand and improved liquidity. The fluctuations in their performance highlight the sensitivity of the money broking industry to broader economic and financial conditions.

by introducing the Money Broking Regulation and a Code of Conduct, ensuring compliance with operational standards, risk management practices, and global best practices. With the enactment of the Central Bank of Sri Lanka Act No. 16 of 2023, which classifies AMBs as financial institutions, regulatory oversight has become more stringent, reinforcing market stability and investor confidence. These measures contribute to the continued growth and integrity of the money broking sector, ensuring a stable and efficient financial market in Sri Lanka.

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Collateral Policy under Open Market Operations



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1. Background

This article explores the evolving role and strategic design of collateral policy within central bank monetary operations, particularly in response to systemic financial disruptions such as the Global Financial Crisis (GFC) and the COVID-19 pandemic which includes areas such as how collateral frameworks have adapted to support broader policy objectives beyond traditional short-term interest rate control, including long-term liquidity provision, financial market stabilization, and balance sheet protection. By analyzing the diverse approaches taken by advanced economies, the article aims to explore the Sri Lankan experience in ensuring monetary policy transmission and safeguarding financial stability in volatile economic environments.

The monetary policy operations of a country are crucial in achieving the primary purposes of a central bank. During the GFC and the economic downturn triggered by the COVID-19 pandemic, central banks among the globe adopted range of policy measures, leading to a substantial expansion of their balance sheets. In this context, flexible and resilient collateral policies have become increasingly important to ensure smooth market

functioning. These developments have intensified discussions on the significance of collateral frameworks, particularly in advanced economies.

Hence, collateral policy plays a critical role in the execution of open market operations (OMOs), influencing liquidity management, financial stability, the overall effectiveness of monetary policy, and the protection of the central banks' balance sheet. Recognising these factors, central banks across different countries have developed distinct collateral frameworks to support their OMOs, reflecting variations in financial market structures, risk appetites, and policy objectives. Central banks design their collateral policies with two main objectives, such as safeguarding their balance sheets against possible losses from counterparty defaults and supporting wider areas related to monetary policy implementation and the stability of the financial system. The importance of collateral policy gained prominence during the financial market turmoil triggered by the GFC and the COVID-19 pandemic, attracting greater attention than before.

Prior to the GFC, central banks in most advanced economies primarily operated within a framework focused on short-term interest rates, limiting

the direct impact of monetary policy operations on collateral markets (Bank for International Settlements, 2015). Nevertheless, after the GFC, central banks expanded their policy focus beyond short-term interest rate control to include longer-term interest rates. Their policies began targeting long-term lending and borrowing activities, as well as foreign exchange interventions to influence exchange rates. As a result, the design of collateral policies was reshaped to better align with the evolving objectives of monetary policy implementation.

2. Collateral Policy and Its Importance

Central banks carry out market operations to implement monetary policy, such as OMOs, where the central bank buys or sells government securities to control liquidity in the banking system. Central banks require security when providing liquidity through overnight, short-term, or long-term open market operations (OMOs), as well as through overnight Standing Facilities (SF). Recent collateral frameworks are structured to guarantee the efficient implementation of monetary policy operations and the uninterrupted operation of payment systems, while also lessening counterparty credit risk. (Chailloux, Gray and McCaughrin, 2008). Accordingly, when a central bank provide funds to the participants, some form of security is required against default risk accompanying with these types of lending transactions. Therefore, each central bank has a collateral framework that varies across the central banks in terms of rules and principles, and the range of asset classes, etc.

Collateral policy refers to the framework of guidelines and rules that govern how assets are evaluated, assessed for risk, and accepted as collateral in lending transactions. (Zorn and Garcia, 2011). Collateral define as assets pledged as security for lending transactions, ensuring lenders have alternative in case of borrower default. It involves specific eligibility criteria for different

asset types, helping to mitigate lender losses. Additionally, the borrower is obligated to repay the loan to reclaim the pledged security. Central banks collateral policy is a part of a monetary policy and therefore, having a good collateral policy in central banks can minimize a few main risks associated with the monetary policy implementation process. Furthermore, the absence of a sufficient collateral policy creates significant risks for the central bank. Collateral is crucial for mitigating both credit risk and liquidity risk associated with lending transactions. To manage liquidity risk in lending, haircuts are applied to collateral, however, liquidating non-marketable collateral can take several years. Accordingly, a minor loss may have a minimal impact on the central bank's balance sheet, but a substantial loss could threaten its independence. Losses incurred by the central bank often result in an expansion of the monetary base, potentially reducing control over the balance sheet. If these losses are significant, they could undermine the central bank's ability to maintain low inflation, thereby disrupting its primary economic objectives (Chailloux, Gray and McCaughrin, 2008). Further, collateral-based lending imposes restrictions on which institutions can participate, thereby influencing their interaction with the central bank. Without requiring collateral for market lending, banks facing higher funding costs would be more inclined to rely heavily on central bank borrowing.

During the COVID-19 pandemic, central banks around the world took unprecedented measures to maintain monetary and financial system stability and ensure their own solvency while supporting the recovery of the economy. Accordingly, they implemented large-scale asset purchase programs that was commonly known as quantitative easing (QE), to inject liquidity into financial markets and prevent credit shortages. Interest rates prevailed at that were slashed to near zero or even negative levels in some instances, reducing borrowing costs for firms and households. In addition, central banks

also introduced emergency lending facilities with a view to providing direct support to commercial banks and to prevent systemic failures. Close coordination with governments by the central banks was also seen during the pandemic to facilitate fiscal stimulus measures, ensure smooth debt issuance and maintain confidence in sovereign bonds. Regulatory flexibility was also provided to financial institutions, allowing them to provide debt moratorium and absorb pandemic-related financial shocks. Hence, these measures helped in varying degrees to stabilize financial markets, economic recovery, and safeguard the solvency of central banks regardless of worsened risks and economic uncertainty.

3. Collateral Policy of Different Central Banks

Liquidity within financial markets shows a pivotal role in keeping the interest rate stability of the economy. In the event of insufficient liquidity in the market, it is crucial for central bank to provide adequate liquidity in achieving its main objectives of maintaining monetary and financial system stability. An adequate and well-regulated supply of liquidity ensures that short-term interest rates remain within targeted ranges, facilitating smooth monetary policy transmission. Sustaining an optimal level of liquidity is essential for macroeconomic stability and the efficient functioning of financial markets. When offering lending facilities, central banks must secure appropriate collateral to sufficiently cover potential losses in case of default. In designing collateral policy, central banks must take two areas into account. First, the collateral policy should maintain sufficient flexibility to enable the effective implementation of monetary policy. Second, the policy must ensure that banks pledge high-quality assets as collateral, thereby lessening the central bank's exposure to counterparty risk. The collateral policy of central banks has been largely discussed since the GFC and COVID 19 pandemic period and as a result, haircuts (margins)

are used extensively in relation to collateralised lending by the central banks.

At the beginning, central banks used discounted short-term commercial bills as collateral when providing liquidity to the market. During that time, alternative instruments that can be used as collateral are comparatively less and on the other hand the financial markets are also not much developed. In addition, the “Real Bills Doctrine” was also used as protection against credit risk. Real Bills Doctrine refers to a norm in which currency is issued in exchange for short-term debt instruments, typically at a discount. Further, Real Bills Doctrine, limiting banks to only or primarily issuing money that is adequately backed by equally-valued assets will not contribute to inflation. However, the practices and the importance the collateral policy urged during the GFC focused mainly on effective monetary policy implementation.

Bindseil and Papadia (2006), summarises the design of a central bank's collateral policy in different phases, which include desirable characteristics of eligible collateral, risk mitigation techniques, and monitoring the collateral framework. Accordingly, the need for different types of collateral is important in order to mitigate risks associated with central bank operations. Further, they have highlighted that selected collateral must have different types of attributes such as legal certainty, credit quality and easy availability of credit assessment, easy pricing and liquidity, handling costs and available amounts and prospective use. These types of attributes are essential when designing a collateral framework for any central bank.

The developed countries use a variety of collaterals as their financial markets are well developed than in developing countries. Further risk mitigation techniques are also crucial for central bank as different types of collateral hold differing degrees of risk. Therefore, risk mitigation measures such as valuation and margin calls, limits, haircuts and

Table 1: Collaterals Accepted by Different Central Banks

Country	Eligible Collateral	
	Open Market Operations (OMOs)	Standing Facility (SF)
ECB	Central Government securities, Unsecured bank bonds, corporate bonds, regional government securities, Covered bank bonds, Asset-backed securities, non-marketable assets (credit claims, fixed deposits, cash)	Central Government securities, Unsecured bank bonds, corporate bonds, regional government securities, Covered bank bonds, Asset-backed securities, non-marketable assets (credit claims, fixed deposits, cash)
Australia	Australian government securities, Bank and non-bank securities, Asset-backed securities, foreign securities, Bonds, Money market instruments	Australian government securities, Bank and non-bank securities, Asset-backed securities, foreign securities, Bonds, Money market instruments
Canada	Canadian dollar assets	Directly issued government of Canada marketable securities denominated in Canadian dollars
China	High-quality bonds and loans	Government bonds, Central bank bills, Policy bank bonds, Government-sponsored bonds, Other high-quality bonds
Japan	Government bonds, Treasury discount bills, Government-guaranteed bonds, Municipal bonds, corporate bonds	Government bonds, Treasury discount bills, Government-guaranteed bonds, Municipal bonds, corporate bonds
Malaysia	Ringgit-denominated securities issued by the Government of Malaysia and BNM, Selected corporate bonds and sukuk with minimum A3 or A- domestic ratings	Ringgit-denominated securities (Government of Malaysia securities, Bank-issued securities, EMEAP-member government securities, corporate bonds, Sukuk with minimum ratings, Bankers Acceptances, Negotiable Instruments of Deposits issued by licensed banks, etc.), non-ringgit denominated securities (US Treasury Securities, UK Gilts, Securities issued by multilateral institutions, etc.)
Singapore	Singapore government securities, FX Swap (US dollars)	Singapore government securities, MAS bills, SGD debt securities
Thailand	Government bills and bonds, Government-guaranteed state enterprise bonds or state enterprise bonds with AAA rating, Central bank bills and bonds	Government bills and bonds, Government-guaranteed state enterprise bonds or state enterprise bonds with AAA rating, central bank bills and bonds, USD, Securities issued by governments and central banks of countries with which BOT has signed CBCA
Indonesia (Conventional)	Bank Indonesia Certificates, Bank Indonesia Deposit Certificates, Bank Indonesia Rupiah Securities, Sukuk Bank Indonesia, Sovereign Bonds, Surat Berharga Negara	Bank Indonesia Certificates, Bank Indonesia Deposit Certificates, Sukuk Bank Indonesia, Surat Berharga Negara, Sovereign Bonds
India	Central and state government securities	Government securities, including state government securities

Source: Individual Central Bank's websites

replenishment procedures are also required to be differentiated according to the type of collateral. Central banks follow a number of haircut policies when pricing securities in order to mitigate risks associated with lending by the central banks for their counterparties.

However, collateral frameworks in different central banks place their importance on various aspects when they are reshaping their existing frameworks. Accordingly, the Federal Reserve Bank of New York aims for market neutrality. Under the short-term OMO of the Federal Reserve Bank, the collateral pool is narrowly defined, and operations are conducted at market-related rates. Meanwhile, the Euro system places greater emphasis on counterparty neutrality rather than market neutrality and defines its eligible collateral pool in such a way that access to operations is open to a very wide range of counterparties. When lending to participants, the ECB requires the collateral to mitigate counterparty risk. Only euro-denominated bonds are eligible as collateral. This collateral is subject to valuation haircuts.

The Bank of Japan's (BOJ) guidelines on entitled security prioritize maintaining the soundness of its balance sheet and ensuring operational efficiency. Its "level-playing field" method aligns closely with that of the ECB, mainly in the restriction to assets denominated in domestic currency. The BoE places emphasis on both liquidity and credit risk, requiring high-credit-quality collateral for use in both OMO and SF. The following table represents the different collaterals used by different central banks.

4. Sri Lankan Experience on Collateral Framework

The Central Bank of Sri Lanka (CBSL) initiated modernization of its monetary policy framework since 2015 and successfully implemented the Flexible Inflation Targeting (FIT) framework in

2020 and then moved to a Single Policy Interest Rate mechanism in November 2024. CBSL also follows a similar process in implementing its monetary policy in comparison to other central banks. The key monetary policy tool of the present system of monetary policy operations includes the Overnight Policy Rate (OPR). OMOs, SF and Statutory Reserve Requirement (SRR) are the other monetary policy tools that CBSL used to manage domestic money market liquidity. OMO auctions are used to maintain overnight interest rates at or around OPR. Accordingly, in a excess liquidity condition where overnight rates face downward pressure from the OPR instruments such as repo auctions are used to absorb the excess liquidity. Similarly, reverse repurchase auctions are conducted to address upward pressure on overnight rates, particularly in deficit liquidity condition. In addition, standing facilities are provided at the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) to participants to meet any residual requirements not fulfilled through OMO auctions or through the market.

As per the existing collateral policy of the CBSL only government securities (Treasury bills and Treasury bonds) are eligible as collateral for OMOs and SLF are. Such securities pledged as collaterals under CBSL operations are subject to a haircut based on the tenure of the facility and as well as the remaining maturity period of the collateral, with the corresponding yield rates are calculated for each International Securities Identification Number (ISIN). Further, the maturity of the securities pledged must exceed the tenure of the operation in which they are used as collateral.

Additionally, during pandemic period the CBSL took measures to strengthen the existing mechanism on provision of Emergency Loan and Advances (ELA) for licensed banks by broadening its collateral base. This included Foreign currency denominated Sri Lanka government securities, Rupee denominated quoted public shares in the

Colombo Stock Exchange, Rupee denominated quoted public corporate bonds listed in the Colombo Stock Exchange (CSE), Loans secured by mortgages over residential immovable property, Loans secured by mortgages over corporate immovable property, Pawning advances, Vehicle loans/leases, Land and buildings of licensed banks. However, these instruments are currently not eligible for the regular operations of OMOs and SLF.

Considering the existing collateral framework for Sri Lanka, there is an potential to further develop the CBSL's collateral policy by incorporating new instruments, introducing risk-based haircuts based on the collateral and characteristics, collateral pre-positioning practices etc. Instruments such as FX swaps, and debentures may explored as novel collateral to the collateral pool of the existing framework. Developing a pricing mechanism for these instruments in Sri Lanka would be another novel initiative and a significant undertaking which will require careful consideration and structured implementation.

5. Summary

Providing liquidity to the market comes at a cost to the central bank. To balance various objectives, most central banks expand the range of eligible collateral beyond domestic-currency government securities. This requires managing trade-offs between limiting additional risks—such as credit, liquidity, exchange rate, and operational risks—while ensuring broad counterparty access for effective monetary policy implementation and liquidity management.

With the experience of the recent financial crisis and the COVID-19 Pandemic, the CBSL is also

in the process of reviewing its existing collateral policy, anticipating further developments in the financial market as well. Among them, measures were taken to strengthen the existing mechanism on the provision of ELA by expanding the eligible collateral base to different types of collaterals, such as shares listed in the CSE, movable and immovable properties. Expansion of the collateral base diversifies liquidity operations of the CBSL, making the financial system more resilient to shocks by ensuring banks and financial institutions can access funding against a broader set of assets. Further, in times of economic downturns or banking crises, a broader collateral base allows CBSL to respond more flexibly by injecting liquidity into stressed segments of the economy.

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The UNFCCC Framework in Action: Evaluating Global Climate Commitments on Mitigation, Adaptation, and Loss & Damage



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Introduction

Climate change is no longer a distant concern and its impacts are being felt across every continent in the world, from unprecedented heatwaves to devastating floods. It disrupts economies, displaces communities, and threatens the stability of ecosystems, where the world requires a unified response under a shared international framework. Accordingly, the United Nations Framework Convention on Climate Change (UNFCCC) was established in 1992 during the Rio Earth Summit in Brazil with the primary objective of stabilizing greenhouse gas (GHG) concentrations in the atmosphere at a level that prevents dangerous human-induced interference with the climate system. The UNFCCC serves as the foundational international treaty for addressing climate change and has provided the framework for significant climate agreements, including the Kyoto Protocol and the Paris Agreement.

Conference of the Parties (COP) is the principal decision-making body of the UNFCCC. The inaugural COP was held in 1995 in Germany, while the 30th COP is scheduled to be held in Brazil in November 2025. It brings together 198 countries in the world (both developed and developing countries) into a common platform to coordinate global cooperation in climate actions.

The parties meet annually to assess the progress and effectiveness of climate actions and ensure support for developing countries financially, technologically, and with capacity building to address the impacts of climate change. The framework adopted the principle of “common but differentiated responsibilities” from its inception. Accordingly, Annex I parties (developed countries) are required to submit GHG Inventories annually under the binding commitments to take the lead in reducing emissions. Meanwhile, Non-Annex I parties (developing countries) were also encouraged to submit GHG inventories as part of their National Communications (NCs) every four years, but not obligated.

This study examines the timely actions taken by the framework primarily in addressing mitigation and how its scope progressively expanding to adaptation and Loss & Damage (L&D) in response to the frequent and intensifying impacts of climate change. Understanding the evolution of these efforts is essential to appreciate how the UNFCCC has guided global climate action over the past three decades.

Evolution of climate change mitigation under the UNFCCC

Climate change mitigation refers to actions taken to reduce GHG emissions, focusing on slowing down

global warming and limiting the adverse effects of climate change. It promotes cleaner energy sources such as solar and wind while improving energy efficiency, sustainable land use practices like reforestation, and also adopting low-carbon technologies in various sectors. Accordingly, the focus of the UNFCCC was essentially on advancing mitigation actions from 1992 to 2000.

The first milestone of the mitigation agenda is the Kyoto Protocol which adopted at COP 3 in Kyoto, Japan, in 1997. As the first legally binding agreement under the UNFCCC, 37 developed countries and economies in transition agreed to reduce GHG emissions by an average of 5.2% below 1990 levels during 2008–2012. Under the protocol, three market-based mechanisms were introduced, including the Clean Development Mechanism (CDM), Joint Implementation, and Emissions Trading. Notably, the CDM began its operations in 2005, allowing developed countries to meet part of their obligations by investing in emission-reduction projects in developing countries while bringing mitigation benefits alongside development gains.

By the time of COP16 in Cancun, Mexico, in 2010, developing countries were included in the mitigation agenda by officially recognizing the concept of Nationally Appropriate Mitigation Actions (NAMAs). It allowed developing countries to engage in GHG mitigation actions under the principle of “common but differentiated responsibilities”. The Green Climate Fund (GCF), was also created during this period. It designed to mobilize \$100 billion annually by 2020 from public and private sources for funding mitigation and adaptation projects in developing countries.

Mitigation efforts continued with the Warsaw Framework for REDD+, adopted at COP19 in Poland in 2013. REDD+ (Reducing Emissions from Deforestation and Forest Degradation) is a climate mitigation mechanism which introduced to developing countries to access climate finance by verifying the reduced emissions from the forest

sector. This mechanism rewarded the climate mitigation projects in developing countries, which were designed to combat climate change through forest conservation, sustainable land use, and enhancing forest carbon stock.

The Paris Agreement, adopted at COP21 in France in 2015 is the turning point of climate agenda under the UNFCCC. This agreement introduced a bottom-up system of “Nationally Determined Contributions” (NDCs) unlike the top-down approach of the Kyoto Protocol. This required all parties of the Paris agreement to submit their NDCs every five years in pursuing efforts to limit global warming well below 2°C, preferably to 1.5°C above pre-industrial levels where they are legally binding with the procedures to submit timely plans but not on the emission targets. These plans explain how countries will reduce their GHG emissions by setting their own emission reduction targets while setting net-zero emission targets in the long term. It also requires the parties to submit Biennial Transparency Reports (BTRs) every two years from 2024 under the Paris Agreement to report the progress on NDCs, GHG Inventories and support needed & received.

At COP26 in Glasgow in 2021, the Glasgow Climate Pact urged countries to strengthen their NDCs by the end of 2022, and also the parties agreed to phase down unabated coal for the first time in COP history recognizing the current pledges were insufficient to meet the 1.5°C target.

The first Global Stocktake (GST), completed at COP28 in Dubai in 2023 measured the collective progress of climate actions under the Paris Agreement. It was found that current mitigation efforts are insufficient, and NDCs of many countries are not ambitious enough for achieving net-zero targets by 2050. The GST also highlighted that developing countries lack adequate finance, technology, and capacity-building to realize their full mitigation potential and enhance resilience for changing climate.

Evolution of climate change adaptation under the UNFCCC

While mitigation remained prioritize in the climate agenda of the UNFCCC in the early years, the Intergovernmental Panel on Climate Change (IPCC) revealed that it takes a longer time to stabilize the climate only with mitigation actions. Many developing countries, especially Least Developed Countries (LDCs) and Small Island Developing Nations (SIDs), suffer a lot due to severe impacts of climate change. As a result, adaptation was recognized after 2000 as complementary to mitigation in climate strategies in the UNFCCC process.

The Marrakesh Accord, adopted at COP7 in Morocco in 2001 is the first significant step in the direction of adaptation. The Adaptation Fund which linked to the Kyoto Protocol was established to finance adaptation projects in developing countries vulnerable to climate change and funded by a share of proceeds from CDM projects. Additionally, the Least Developed Countries Fund (LDCF) was also established under the Global Environment Facility (GEF) to support adaptation activities in developing countries in line with the implementation of National Adaptation Programmes of Action (NAPAs).

At COP16 in Cancun in 2010, the Cancun Adaptation Framework (CAF) was launched, introducing National Adaptation Plans (NAPs) to strengthen action on adaptation. Developing countries, particularly LDCs, were encouraged to identify medium and long-term adaptation needs under NAPs. These NAPs were expected to build on the experience gained by NAPAs to support the integration of adaptation into national development planning.

The Paris Agreement in 2015 elevated adaptation to equal standing with mitigation by recognizing that climate change is already happening and global cooperation is necessary to strengthen the adaptive

capacity, resilience and reduce vulnerability. Accordingly, Article 7 was dedicated to adaptation by establishing the first-ever global adaptation goal, aiming to ensure adequate adaptation response for 1.5°C–2°C temperature goal. The parties were encouraged to communicate their adaptation priorities, including implementation actions and support received or needed which identified under NAPs, through NDCs and report the progress through BTRs. Further, adaptation was also identified as a core component of the Global Stocktake which carries out every five years, starting from 2023 for tracking collective progress.

Evolution of Loss and Damage under the UNFCCC

The concept of Loss & Damage was introduced to address irreversible impacts of climate change that cannot be avoided through mitigation or adaptation. The focus of the UNFCCC gained prominence in L&D after recognizing that some climate impacts are beyond the limits of adaptation. These climate impacts include both economic losses like crop and infrastructure damages and non-economic losses like cultural and biodiversity losses. The UNFCCC officially recognized L&D mechanism as a complementary pillar to mitigation and adaptation in the early 2010s.

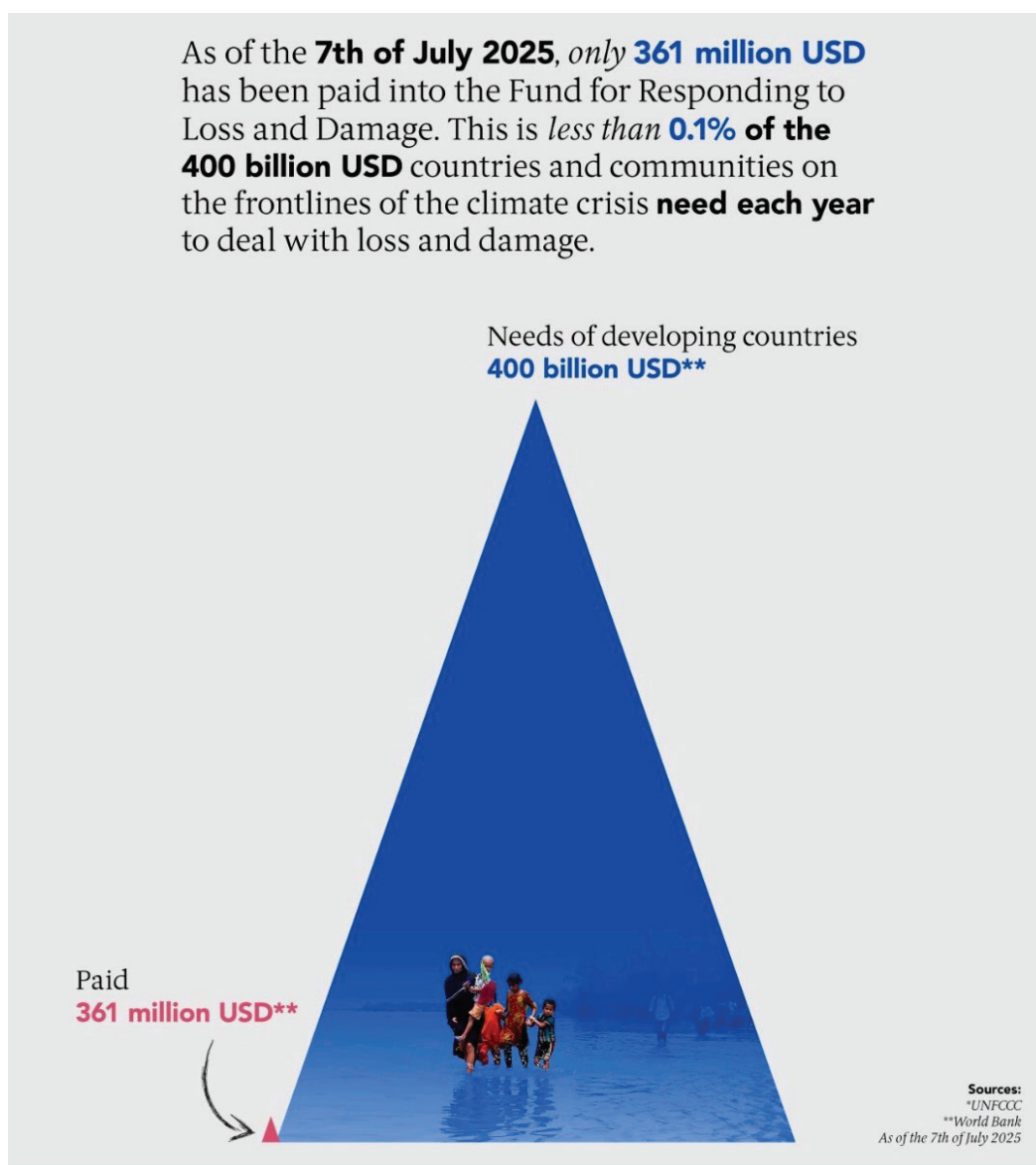
The Warsaw International Mechanism (WIM) for L&D, which structured for climate risk reduction and risk transfer (insurance), was established at COP19 in Poland in 2013 as the main institutional arrangement under the UNFCCC. The L&D mechanism was also recognized under Article 8 of the Paris Agreement in 2015 as a separate pillar, alongside mitigation and adaptation. Further, at COP25 in Madrid in 2019, parties launched the Santiago Network for Loss and Damage under WIM to connect vulnerable developing countries with technical support, knowledge, and resources. Ultimately, the parties reached a historic agreement to establish a Loss and Damage Fund at COP27 in

Sharm el-Sheikh in 2022. This was considered as landmark step taken towards climate justice.

The L&D Fund is a solidarity fund that aims to provide financial support from historically high-emitting developed countries to developing countries that are vulnerable to the adverse climate change impacts, especially when those impacts are beyond the limits of adaptation. Therefore, the fund reflects climate justice and global solidarity. This fund is supposed to bail out people suffering

from the Climate Crisis. The success of the fund will be its ability to mobilize and scale up resources and to ensure that communities for whom the fund was set up, in fact, benefit from those resources. Accordingly, the L&D Fund became operational at COP28 held in Dubai in 2023, with initial financial pledges from countries including the UAE, Germany, the UK, the US, and the EU. The World Bank was chosen as an interim host of the fund for the first four years.

Figure 1: Stark gap between L&D finance needs and actual contributions as of July 2025



Source: UNFCCC; World Bank

The role of central banks with the establishment of the L&D Fund

The role of central banks in supporting climate actions is significant, even though their core mandates focus on monetary and financial stability. Accordingly, central banks are expected to play a proactive role particularly with the establishment of the L&D Fund in 2023 since this mechanism deals with irreversible climate impacts that go beyond the limits of adaptation in vulnerable countries. Central banks can support its effective implementation by monitoring the macroeconomic and financial spillover effects of L&D events, particularly in climate-vulnerable economies, and work with global partners to ensure liquidity support after climate shocks. Macroeconomic and financial spillover effects refer to the wider economic and financial consequences that extend beyond the immediate affected area and influence financial stability. Contraction of Gross Domestic Product (GDP) of the country after a major cyclone, rising inflation due to loss of food production, reducing labor productivity due to displacement of people, increasing government borrowings to rebuild infrastructure destroyed by the extreme weather events, and disrupting trade flows due to flood-damaged roads and ports can be considered as macroeconomic spillover effects of L&D events. Further, increasing default risk in the banking sector due to disaster hits, reducing investments due to losing investor confidence in vulnerable regions, raising insurance premiums, and affecting exchange rates due to climate shocks can be considered as financial spillover effects. Moreover, the interconnectedness of the global systems can spread the effects by disrupting the global supply chain, increasing cross-border migration, and affecting international financial markets. Therefore, central banks shall create support mechanisms that blend L&D funds with public and private finance to ensure that funds flow into local financial systems while developing financial infrastructure to absorb and efficiently distribute L&D finance.

Conclusion

The creation of a fully operational funding mechanism for L&D has become a core part of global climate policy. Accordingly, the focus of UNFCCC is now shifting from negotiation to implementation, particularly ensuring that the L&D Fund delivers real, timely support to vulnerable communities, NDCs are implemented effectively and developing countries implement their long-term strategies such as NAPs with the support of developed countries. Meanwhile, the first Global Stocktake highlighted that the world is off track to meet the Paris goals, and it emphasized the need for stronger NDCs in 2025 and beyond, which is supported by enhanced sectoral action plans (e.g., in energy, transport, agriculture) and mechanisms to track progress. Therefore, the UNFCCC shall push for accelerated deployment of clean energy, AI-based monitoring, advanced early warning systems, intergenerational justice, indigenous rights, and gender equity in climate policy to ensure that developing countries are not left behind.

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