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IN THIS ISSUE

02

The Role of Deposit Insurance in Ensuring Financial System Stability

08

Global Pension Assets: Sri Lanka's Standing and the Road Ahead

16

High Returns, Hidden Risks: Identifying Illegal Finance Schemes



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The Role of Deposit Insurance in Ensuring Financial System Stability

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Deposit insurance serves as a vital protective mechanism in modern financial systems. It protects depositors from the losing their savings in the event of the failure of a financial institution (FI). Simultaneously, it mitigates the risk of widespread panic withdrawals, thereby bolstering financial system stability. Over the past two decades, the scope and robustness of deposit insurance frameworks have expanded notably, particularly in response to the Global Financial Crisis of 2007–2008.

This article explains the operational mechanisms of deposit insurance, its critical necessity, the design of global systems and the evolution of Sri Lanka's Deposit Insurance Scheme (SLDIS). It further examines recent reforms implemented under the Financial Sector Safety Net Strengthening Project (FSSNP) supported by the World Bank, concluding with insights into Sri Lanka's ongoing efforts to enhance its deposit insurance framework in alignment with international standards.

1. Understanding the Concept of Deposit Insurance

FIs play a vital role in modern economies by collecting deposits from the public and channeling

these funds into productive uses through lending to businesses and individuals. This process supports investment, consumption, and economic growth. FIs operate on a fractional reserve basis, keeping only a part of deposits as liquid reserves while lending the rest to borrowers.

The system functions effectively as long as public confidence in FIs is maintained. Problems are encountered when such confidence is weakened. When an FI is believed to be experiencing financial difficulty, deposits may be withdrawn simultaneously by customers. Even fundamentally solvent FIs can be exposed to liquidity crises under these circumstances. This mass withdrawal of deposits is referred to as a 'bank run'.

Deposit insurance was introduced to mitigate such risks by assuring depositors that their funds are protected up to a certain limit, even if the FI fails. This assurance reduces the likelihood of panic withdrawals.

The importance of deposit insurance became evident during major financial crises. Research by Diamond and Dybvig (1983) demonstrated that bank runs can be triggered by depositor fear of others withdrawing funds. Deposit insurance helps

to break this cycle of fear, thereby reinforcing confidence in the FIs.

Deposit insurance serves three primary purposes:

- Protecting small depositors, including households and small businesses.
- Reducing the risk of bank runs and preventing financial contagion.
- Supporting orderly resolution processes when financial institutions fail.

Modern deposit insurance systems play a key role in managing the failure of FIs by ensuring the timely reimbursement of insured depositors or facilitating the transfer of insured deposits to viable FIs. This helps to minimize contagion effects and maintain financial stability. Such mechanisms reduce panic-driven withdrawals and ensure continuity of essential financial services, limiting broader market disruption.

However, deposit insurance must be carefully designed. Excessive coverage can encourage risky behavior by FIs, known as 'moral hazard'. To address this, most systems impose coverage limits and integrate deposit insurance with prudential supervision and regulation. This approach balances depositor protection with market discipline and sound risk management.

2. Operational Dynamics of Deposit Insurance

Despite jurisdictional variations, deposit insurance systems share core characteristics that promote depositor protection and financial stability. Effective schemes maintain public trust, encourage prudent risk-taking by FIs and ensure the seamless functioning of the financial sector.

A strong legal foundation is critical, underpinned by clear and comprehensive legislation that specifies the scope of coverage, the powers of the deposit insurer, funding arrangements and administrative

procedures. Such clarity guarantees transparency, enforceability and consistency of the operations of the deposit insurance scheme. Coverage limits are generally set to fully protect most small depositors while exposing larger deposits to some risk, preserving market discipline.

The deposit insurance mechanism is executed through accumulating funds in advance from its member institutions via an *ex-ante* funding model, whereby member institutions of the deposit insurance scheme contribute regular premiums to a deposit insurance fund. These funds are prudently invested to maintain liquidity and safeguard capital, ensuring readiness to meet potential payout obligations. Many modern frameworks employ risk-based premium systems, requiring higher-risk FIs to pay proportionally greater premiums, thereby promoting sound risk management and equitable cost distribution.

The speed of reimbursing insured deposits is critical to maintaining depositor confidence. According to international best practices, it is more prudent to settle claims of insured depositors within 7 to 20 working days, especially during financial stress. Deposit insurance mandates have evolved from simple “Pay Box” models focusing solely on reimbursement to “Pay Box Plus”, “Risk Minimizer” and “Loss Minimizer” frameworks that also participate in resolution processes, thereby enhancing crisis management and financial stability.

3. International Developments and Standards

Deposit insurance has evolved significantly since its inception. The United States pioneered the concept with the Federal Deposit Insurance Corporation (FDIC) in 1933 following the Great Depression. Since then, deposit insurance has been adopted by many advanced and emerging economies.

A key development in international coordination was the creation of the International Association

of Deposit Insurers (IADI) in 2002 in Basel, Switzerland. IADI, together with the Basel Committee on Banking Supervision, developed the Core Principles for Effective Deposit Insurance Systems, first issued in 2009, and revised in 2014 and 2025, to address recent financial sector changes, including digital risks and lessons from financial sector stresses.

These Core Principles provide guidance on legal frameworks, funding, coverage, governance, operational readiness, crisis coordination and resolution financing. They are widely used by the International Monetary Fund and the World Bank in assessing countries' financial systems under the Financial Sector Assessment Program (FSAP).

Current global practices relating to include:

- enhanced legal frameworks and operational independence,
- expanded and well-capitalized deposit insurance funds,
- implementation of risk-sensitive premium structures,
- accelerated payout processes supported by digital infrastructures,

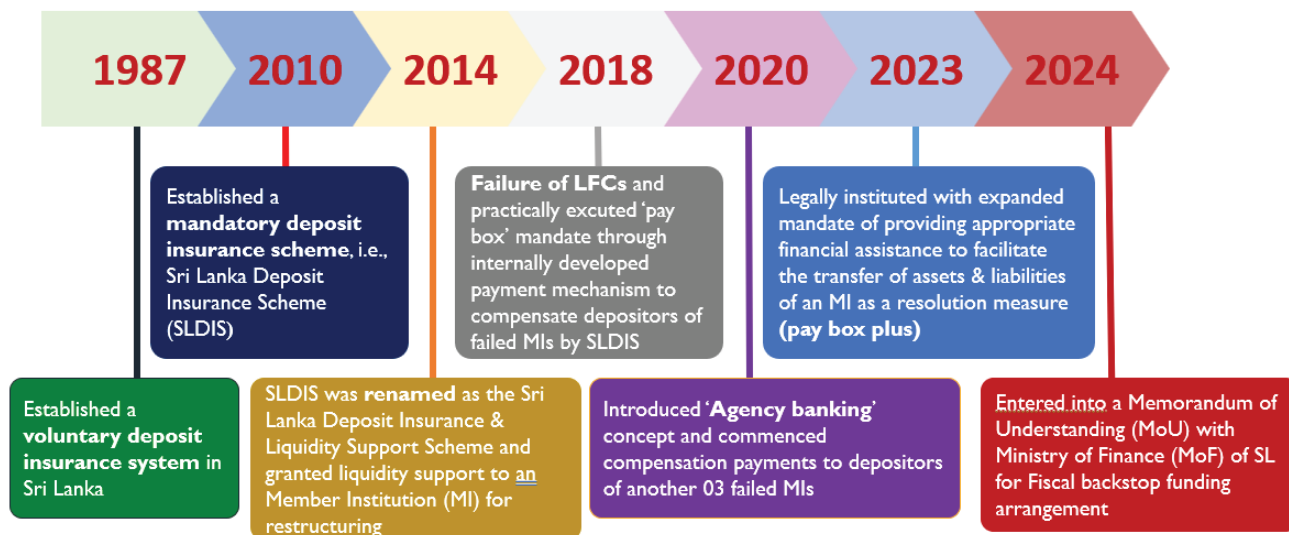
- closer integration with resolution authorities,
- established contingency funding mechanisms, including government backstops,

The Global Financial Crisis of 2007 - 2008 expedited numerous reforms. More recent episodes of financial sector stress have further emphasized the importance of preparedness, crisis simulation exercises and digital resilience.

4. The Sri Lanka Deposit Insurance Scheme (SLDIS)

4.1 Legal Framework and Historical Evolution

Sri Lanka introduced a voluntary deposit insurance arrangement in 1987. A significant advancement occurred in 2010 with the establishment of the mandatory Sri Lanka Deposit Insurance Scheme (SLDIS) under the Monetary Law Act, No. 58 of 1949, which required Licensed Commercial Banks (LCBs), Licensed Specialized Banks (LSBs) and Licensed Finance Companies (LFCs) to become mandatory members of the scheme from 2010 onward. The scheme was



operationalized through regulations issued under the Act, providing a clear statutory foundation for deposit coverage, premium collection and fund administration. This development enhanced depositor protection and aligned Sri Lanka’s financial system with international best practices.

In 2013, the deposit insurance scheme’s title was amended to reflect its liquidity support function. Subsequent reforms under the Banking (Special Provisions) Act No. 17 of 2023 formalized SLDIS and broadened its mandate. Presently, SLDIS operates under a “Pay Box Plus” model, enabling it to not only compensate insured depositors upon revocation of the licence of Member Institutions (MIs) but also to extend financial assistance facilitating the transfer of assets and liabilities during resolution processes. The SLDIS falls under the purview of the Central Bank of Sri Lanka (CBSL) and is administered and managed by the Deposit Insurance and Resolution Department (DIRD) of CBSL, covering LCBs, LSBs and LFCs.

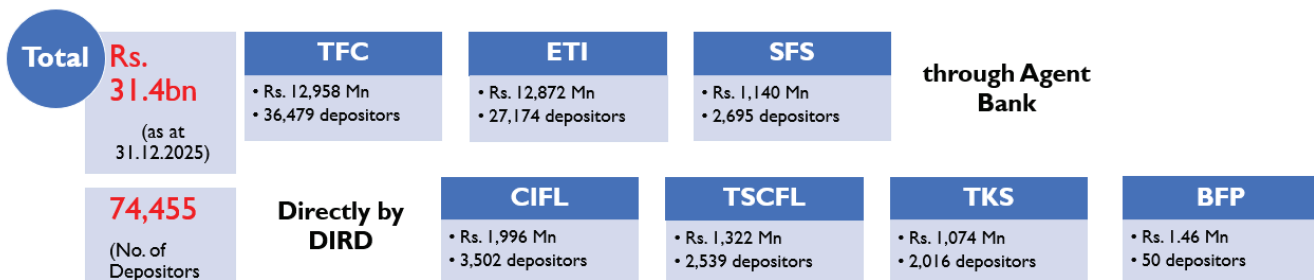
4.2 Coverage Limits and Fund Structure

The current coverage limit stands at Rs. 1,100,000 per depositor per institution, applicable to deposits denominated in both local and foreign currencies, converted at prevailing exchange rates.

SLDIS employs an *ex-ante* funding approach, with member institutions remitting premiums regularly, i.e., quarterly for LLBs and monthly for LFCs. This structure ensures continuous accumulation of reserves, enhances liquidity preparedness and strengthens the scheme’s capacity for timely depositor compensation. The SLDIS has practical experience compensating depositors of LFCs, i.e., Central Investments and Finance PLC (CIFL), The Standard Credit Finance Limited (TSCFL), TKS Finance Limited (TKSFL), The Finance Company PLC (TFC), ETI Finance Limited (ETIFL), Swarnamahar Financial Services PLC (SFSP) and Bimputh Finance PLC (BFP), and has improved payout efficiency through agency banking arrangements, thereby enhancing operational readiness for future contingencies.

4.3 Financial Sector Safety Net Strengthening Project (FSSNP)

The World Bank’s International Development Association finances the (FSSNP), a strategic initiative aimed at bolstering Sri Lanka’s financial sector resilience amid recent macroeconomic challenges. Approved with approximately US \$150 million in funding, the project supports structural reforms to strengthen the financial safety net and boost public confidence in the financial system.



FSSNP focuses on enhancing SLDIS by building institutional capacity, improving financial preparedness and aligning with international best practices as outlined in the revised IADI Core Principles.

The project has three main components:

- **Capitalization of the Deposit Insurance Scheme:**
Increasing SLDIS reserves to improve coverage capacity.
- **Institutional Capacity Building for CBSL:**
Providing technical assistance to enhance CBSL's administration and operational capabilities in relation to deposit insurance, to better align the SLDIS with the IADI Core Principles.
- **Project Implementation and Monitoring:**
Supporting execution, oversight and compliance monitoring in line with the WB's applicable standards of financial management, procurement, social and environmental risk management, monitoring and evaluation, and reporting requirements.

Policy-Based Improvements under the FSSNP

A notable feature of FSSNP is the completion of policy-based improvements, linking fund disbursement to achieving specific reform milestones agreed with the World Bank. This ensures that financing supports substantial improvements in deposit insurance capacity and governance rather than merely providing budget support.

Milestones focus on measurable improvements such as better funding ratios, enhanced operational frameworks, improved payout processes and compliance with international standards.

Key development areas include:

- **Clear Institutional Arrangements:**
Establishing dedicated deposit insurance and resolution functions with separate staffing and reporting lines within CBSL to strengthen accountability.

- **Fiscal Backstop Mechanism:**
Formalizing a Memorandum of Understanding (MoU) between CBSL and the Ministry of Finance to guarantee government support for SLDIS during stress periods.
- **Diversified Investment Policy:**
Adopting an investment policy balancing safety and asset diversification to improve returns while safeguarding capital.
- **Premium Collection and Sustainability:**
Issuing new guidelines to ensure sustainable premium methodologies and reserve growth.
- **Enhanced Transparency and Public Information:**
Requiring member institutions to disclose standardized information about their deposit insurance membership and coverage.
- **Public Awareness and Financial Literacy:**
Conducting the first nationwide survey to measure the existing level of public awareness on the SLDIS and developing long-term public awareness strategies to educate depositors on SLDIS.
- **Contingency Planning:**
Developing plans to manage large or simultaneous payouts in the event of multiple failures.
- **Operational Readiness:**
Implementing guidelines for deposit reimbursement and conducting simulation exercises to improve payout efficiency and readiness.

5. Comparative Analysis and Way Forward

Compared to global best practices, Sri Lanka's deposit insurance framework has achieved significant progress in establishing legal clarity, expanding its mandate and advancing reforms under the FSSNP, supported by a US \$150 million World Bank financing facility. These efforts aim to enhance the resilience and institutional robustness

of SLDIS in accordance with internationally recognized principles.

Reform initiatives focus on strengthening institutional capacity, operational readiness and financial sustainability. The SLDIS is advancing towards risk-based premium systems, while clarifying its role within resolution processes, and improving governance, accountability and transparency.

Nevertheless, further enhancements are necessary to attain full alignment with more developed deposit insurance systems. Priorities include reinforcing cross-border cooperation with foreign deposit insurers, increasing public awareness of SLDIS, and augmenting crisis preparedness and communication strategies. Sustained implementation of FSSNP reforms will be critical in transforming SLDIS from a primarily “pay-box” mechanism into a proactive and integrated contributor to financial system stability.

6. Conclusion

Deposit insurance is essential for protecting depositors and maintaining financial stability. It reduces panic during financial stress and supports orderly management of failing FIs. Over time, deposit insurance systems have become more sophisticated and better integrated into national safety nets.

International standards promulgated by IADI, particularly the Core Principles first issued in 2009, and revised in 2014 and 2025, provide a comprehensive framework for assessing deposit insurance effectiveness.

Sri Lanka’s Deposit Insurance Scheme has undergone substantial development, notably through legislative reforms in 2023 and ongoing enhancements under the World Bank-supported FSSNP.

Continued efforts to improve funding adequacy, implement risk-based premiums, establish fiscal

backstops, leverage digital systems, enhance crisis preparedness and raise public awareness will further strengthen SLDIS. A well-structured and adequately capitalized deposit insurance system not only protects depositors but also reinforces long-term confidence in the financial system.

“During the preparation of this work, the authors used ChatGPT 5.3 in order to improve the language of the manuscript and to restructure sentences. After using this tool, the authors reviewed and edited the content as needed and take full responsibility for the content of the published article.”

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Global Pension Assets: Sri Lanka's Standing and the Road Ahead

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Pension systems have evolved significantly over time, from basic, charity-based arrangements in the West, into structured rights and entitlements that support a wide range of modern retirement schemes. As these systems developed, global pension assets have expanded to claim an increasingly larger share of the asset management industry. Pension funds inherently benefit from long investment horizons and relatively predictable liquidity needs. Nevertheless, they also face the complex challenge of managing assets, whose corresponding liabilities extend far into the future. While demographic challenges such as ageing populations, longer life expectancy and changing social norms and structures continue to exacerbate existing the messures, sustainability of pension systems and assets remain imperative to employees' working lives as well as to capital markets worldwide.

This article examines the evolution of pension assets across the globe, highlighting significant disparities in the size and penetration of pension structures worldwide. Variations across countries/regions reflect differences in social development, policies, demographic structures, fiscal capacities and the sophistication of financial markets. By linking pension asset accumulation to capital market depth, the article underscores the importance of financial market development in safeguarding

retirement systems that need not tap into the public coffers to sustain themselves. Through effective asset allocation, diversification and long-term investment strategies, capital markets could help bridge funding gaps and enhance retirement security that will largely uplift the social wellbeing of the public. It also highlights how strengthening capital markets is not merely a financial sector objective, but a necessary pillar in strengthening long-term social security.

1. Global Pension Industry Assets

The pension industry witnessed an exponential growth in Assets Under Management (AUM), accumulating substantial wealth across the globe over the years. According to statistics compiled by the Organization for Economic Co-operation and Development (OECD), global pension assets reached USD 69.8 tn by 2024 having grown at a robust Compound Annual Growth Rate (CAGR) of 6.4% through the last 23 years. This is while the global GDP has expanded at a CAGR of approximately 5.3%. As a result, pension assets have increased in economic significance, rising from 46% of world GDP in 2001 to approximately 59% by 2024 (Figure 1). Accordingly, retirement savings pools have expanded not only in absolute terms, but also relative to the size of the global economy. To put the scale of this into perspective,

global pension assets exceeded the combined Gross Domestic Product (GDP) of the 8 largest economies of the world by 2024.

This could reflect a combination of factors such as ageing populations and therefore the increased need for retirement savings and the, increasing accumulation of long-term investment returns on pension assets, led by geographical diversification of pension funds. This has enabled them to access opportunities in high-growth economies elsewhere, in order to outperform GDP growth in their domiciled economies in the long run. On the other hand, state-established structural reforms have expanded the funded pension systems in many countries. While comparative growth rates may vary by region, the predominant pattern is clear that pension assets have outpaced overall GDP growth at the macro level, underpinning the rising economic significance of retirement savings pools in the global financial system.

In an era redefined by artificial intelligence and incidental rapid lifestyle shifts, a prominent figure such as Elon Musk has argued that traditional retirement savings frameworks may become ‘irrelevant’ within the next decade or two, as

economic structures evolve unconventionally. Whether technological disruption will fundamentally alter the need for retirement savings remains premature, but current evidence indicates that long-term asset accumulation continues to play a pivotal role in economic stability and retirement security.

2. Alarming Disparity in Pension Assets Distribution Across Regions

As revealed in the 'Pension Markets in Focus 2025' published by the OECD, noticeably uneven distribution of retirement assets could be observed across the world. For the purpose of this study only 87 jurisdictions have been subject to, representing approximately 73% of the world population. And the coverage may differ across continents which may prevent more precise observations from being made. The coverage is graphically presented in Figure 2 which depicts the distribution of pension assets across the world in 2024.

Northern America houses the largest share of pension assets in excess of USD 48 tn which represents approximately 73% of the global pension assets (87 jurisdictions covered in the

Figure 1: Growth of Global Pension Assets vs GDP (2001-2024)

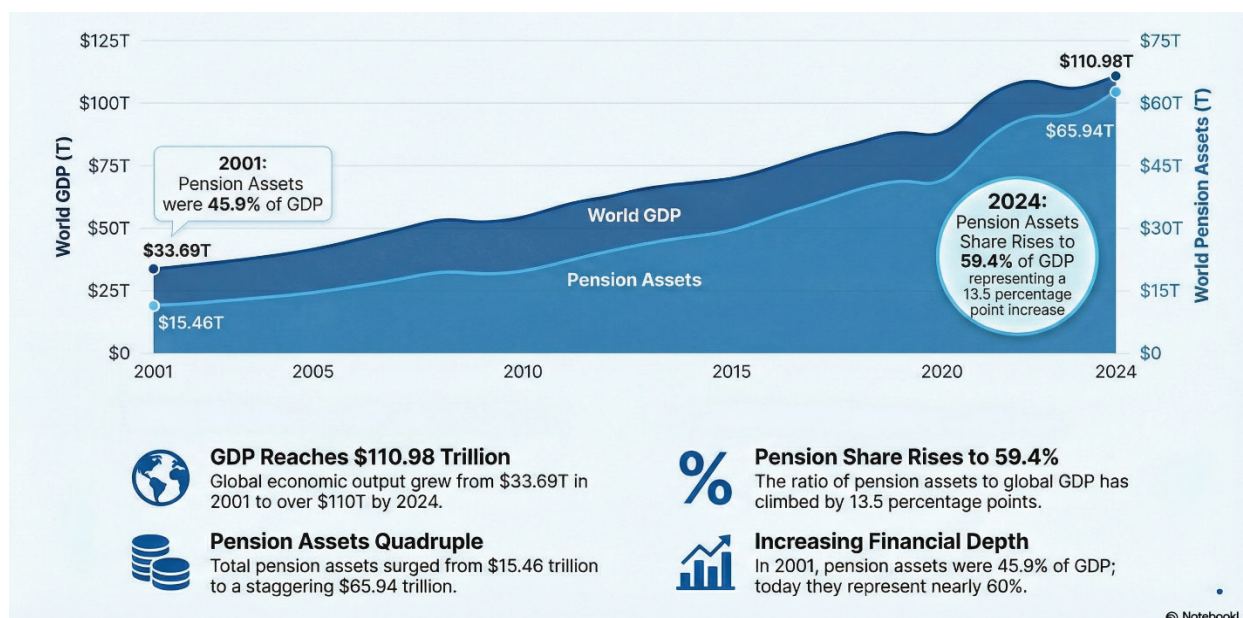
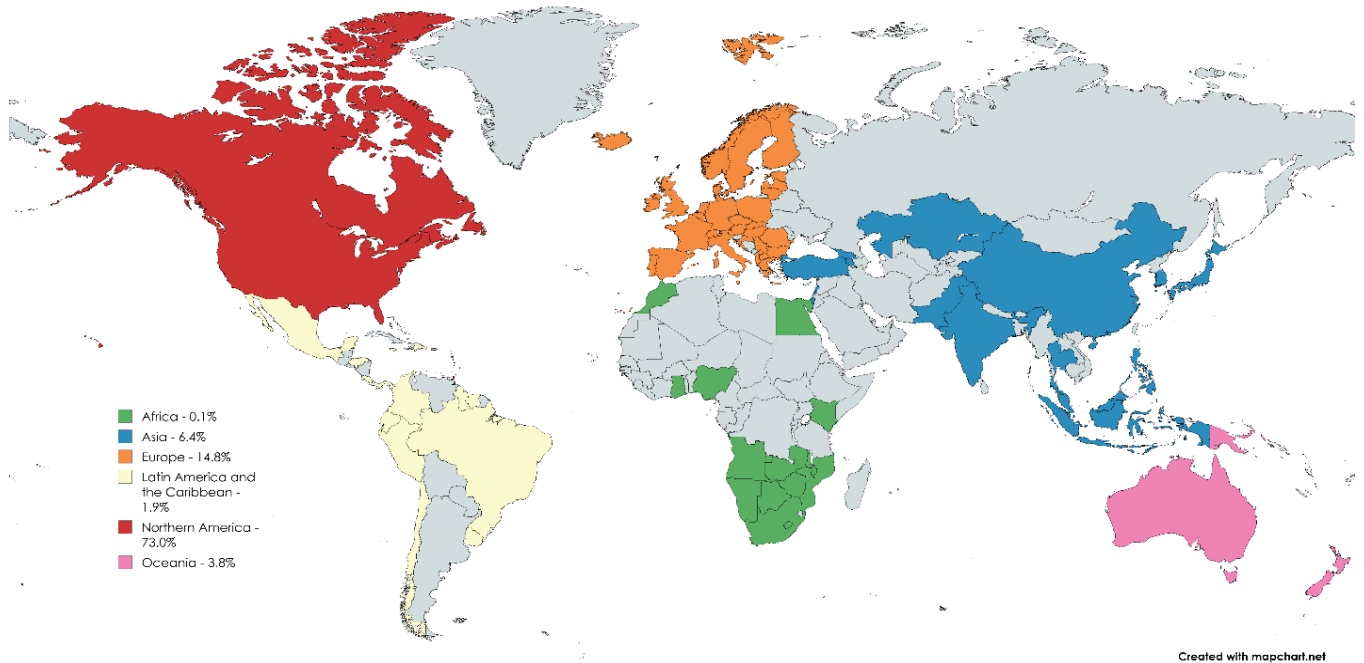


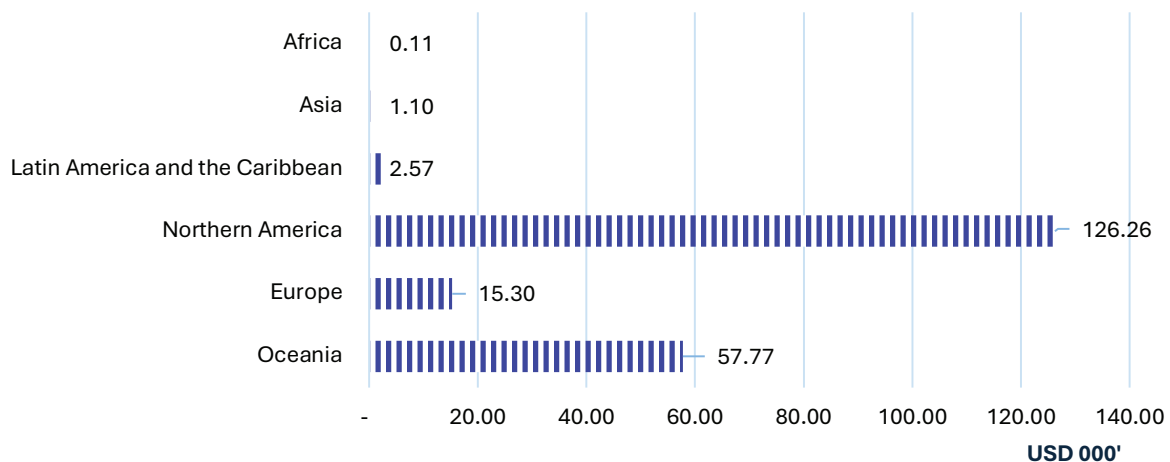
Figure 2: Pension Assets Distribution Across the World



report). In contrast, Asia reported merely 6.4% share of pension assets despite being home to about 60% of the world population. However, the report cites Asia as having nearly USD 3.1 tn assets under ‘public pension reserve funds’, i.e. government managed funds, being the largest among all of the regions. However, due to unavailability of country-wise data for public pension reserve funds, for the purpose of this article only information on ‘pension providers’, i.e. mostly private entities, are used.

As a result, pension assets of certain countries with large pools of assets accumulated in public reserve funds such as Japan, Republic of Korea, Macau and the Philippines might understate total pension backed assets. Africa on the other hand, subject to limited data availability, reported 0.1% of the global pension assets, while Oceania, Europe and Latin America shared 3.8%, 14.8% and 1.9% respectively. Merely this graphical presentation would not do justice to the glaring disparity in

Figure 3: Pension Assets per Capita



Sources: OECD, World Bank

pension assets distribution. Therefore, to put this into perspective, pensions assets are compared to population of the covered jurisdictions on a per capita basis, which unveils the glaring disparity as depicted in Figure 3. Asia is alarmingly underfunded, partly as a result of omitting public pension reserve funds, only ahead of Africa. With Africa’s population being considerably younger than Asia’s, would this pose long-term concerns for the stability and financing of social security programs?

How do Asian Countries Fare?

Pension Markets in Focus 2025 has compiled data of 16 Asian countries with pension assets data for 2024 and Sri Lanka is not among them. Data shows that these 16 countries held USD 1,136.6 bn worth of assets collectively led by Japan, Republic of Korea and India. (However, it should be noted that the total AUM of Government Pension Investment Fund of Japan alone amounted to USD 1.6 tn in 2024 and that the report may have omitted this in the classification under ‘pension providers’.

When reviewing Sri Lanka in this regard, as per the data of Central Bank of Sri Lanka the major contractual savings institutes for pension/superannuation included the Employees’ Provident Fund, Employees’ Trust Fund, other approved pensions and provident funds and Public Service

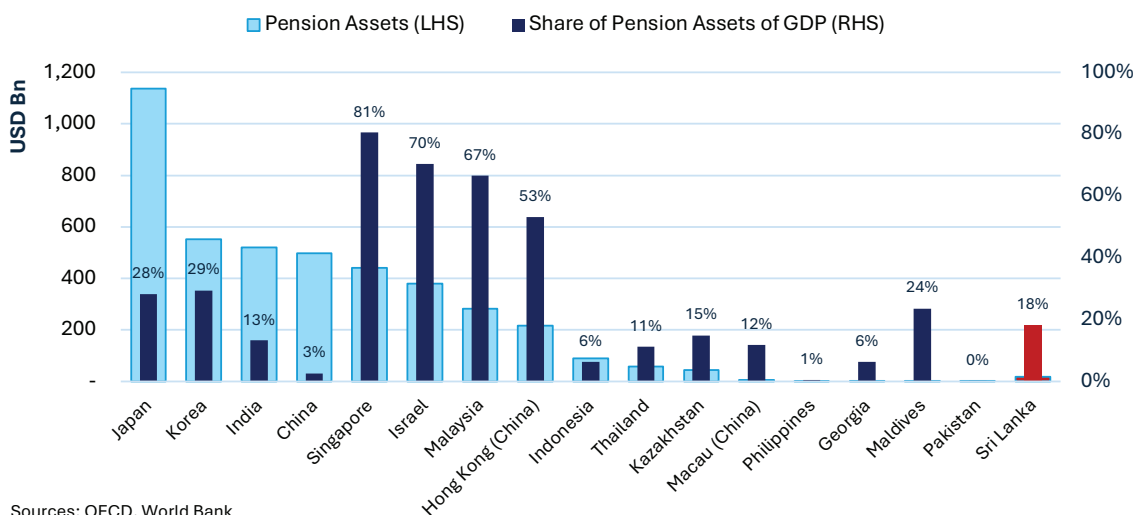
Provident Fund amounting to total assets of Rs. 5,456 tn equivalent to approximately USD 18.2 bn.

Figure 4 captures distribution of pension assets across Asia in terms of absolute asset sizes and relative to the GDP. While Japan, Korea, India and China accounts for the largest asset bases, Singapore (81%), Israel (70%), Malaysia (67%) and Hong Kong (53%) pension assets’ share of GDP exceed half of GDP, shedding light on the magnitude of the pension incomparison to the size of the economy. China being the second largest economy in the world is notably low when considering pensions assets share of GDP. This is in sharp contrast to the US, where pension assets exceeds its economy by 1.56 times. Sri Lanka on the other hand has relatively sizable accumulation of pension assets in excess of 18% of the economy. This is a key measure of untapped long-term savings with multi-decade investment horizons which, if strategically deployed, can drive long-term returns and broader economic growth.

Figure 5: Pension Assets per Capita Vs Population above 65 Years of Age in Asia

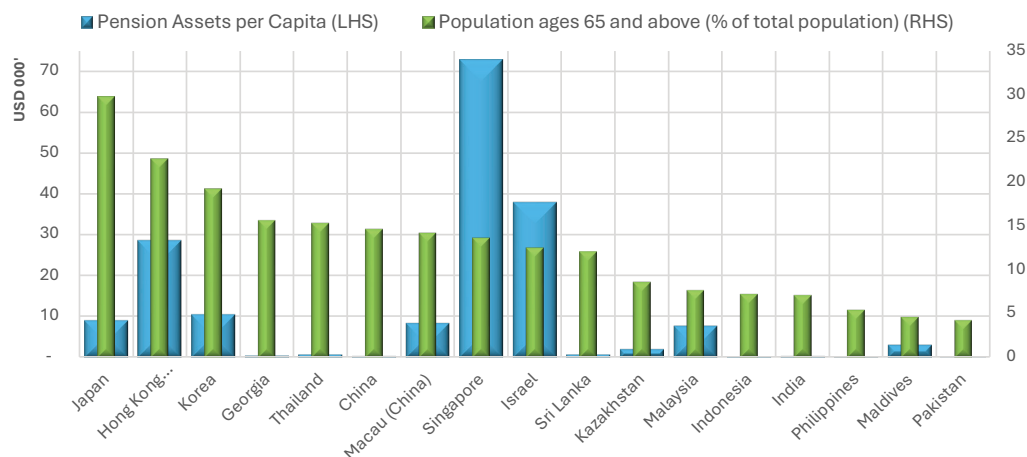
On the other hand, Figure 5 depicts the pension assets per capita against the elderly populations of the respective countries. Among the reported Asian jurisdictions, Singapore, Israel and Hong Kong are countries with the highest pension assets per capita.

Figure 4: Distribution of Pension Assets in Asia



Sources: OECD, World Bank

Figure 5: Pension Assets per Capita Vs Population above 65 Years of Age in Asia



Sources: OECD, World Bank

While per capita pension assets provide a broad indication of the retirement security available to an average individual in a country, a deeper examination of demographic structures offers more meaningful insight into pension accessibility and asset adequacy.

For example, Japan has the world’s second-highest proportion of people aged 65 and above, accounting for 29.8% of its total population. When nearly one-third of the population consists of dependents, organic growth in pension contributions becomes inherently constrained. As more individuals transition into retirement than enter the workforce each passing year, the contributor base starts naturally shrinking. In this context, Japan faces a formidable challenge in adequately funding pensions amid a continuously expanding pension liability without disproportionately burdening its working population.

On the other hand, Sri Lanka has also been confronting the pressures of an ageing population. Although the scale is not yet comparable to that of Japan, Sri Lanka stands out among its regional peers for its rapidly growing elderly demographic, signalling emerging long-term sustainability concerns for its pension system, especially given its dependency status begins earlier i.e. at 55-60 years of age.

Capital Markets Role in Managing Pension Liabilities

One of the fundamental challenges of any pension system is its ever-growing liability. Paradoxically, this liability expands as a country’s social welfare improves. Advances in healthcare, better living standards and overall economic development increase life expectancy. While these are unquestionably positive outcomes, they also mean that individuals spend more years in retirement. As a result, pension systems are required to make payments over longer periods, significantly increasing their long-term obligations.

Another structural concern is the inter-generational nature of pension financing. In many systems, current pension payments are to a greater extent funded by the present working population. This places a disproportionate burden on the current workforce, particularly in instances where economies experience slower growth or aging demographics. As labour force participation rate shifts and dependency ratio rises, funding future pension liabilities sustainably becomes increasingly challenging. In several countries, this has developed into a pressing fiscal and social issue, as governments can afford to allocate only a limited share of fiscal resources into pension commitments.

This is where capital markets assume critical importance. Organic contributions alone, whether from employers, employees or the state are often insufficient to meet growing long-term liabilities.

By investing in pension assets strategically with a long-term view, funds can generate returns that help ease the gap between contributions and obligations i.e. underfunding. When managed prudently and with foresight, long-term investment strategies can ease the strain on public finances and reduce the burden placed on future generations. Pension funds, by their nature, benefit from extended investment horizons, which position them well to capitalize on long-term growth opportunities across asset classes hence play an active role in capital markets.

In the context of Sri Lanka, the structure of retirement benefits reflects a clear distinction between the public and private sectors. Government employees are largely covered by defined benefit schemes, where the state bears the investment and longevity risks. In contrast, private sector employees are lawfully mandated to participate in defined contribution arrangements, in the form of a provident fund. Of this, the ultimate retirement benefit depends on accumulated contributions and investment returns. As such, the risk associated with longevity, i.e. how long a retiree lives and the adequacy of retirement savings is therefore transferred to the individuals rather than the state.

While this framework limits direct fiscal burden for the government, it introduces another dimension of risk. If retirement savings prove insufficient on a broad scale, the consequences may still become systemic led by erosion of quality of life of the elderly population, compelling state intervention. Sri Lanka has resorted to establishing high-interest rate savings schemes for senior citizens, accordingly at the expense of taxpayers. The cost of such mechanisms should ideally be classified as state-funded retirement benefits as far as real economic substance of such expenditure is concerned. Hence, ensuring that pension fund assets generate sustainable and competitive returns is not merely a financial objective but a social imperative as well. Strong, deep and well-regulated capital markets play a vital role in this regard. By facilitating efficient allocation of long-term capital and optimizing investment performance, they help safeguard retirement security and accordingly

contribute to broader economic as well as social stability of a nation.

In essence, the sustainability of pension systems increasingly depends on a careful balance between demographic realities, fiscal discipline and effective participation in capital markets. Without thoughtful long-term investment management, the future burden of increasing pension liability on both the governments and individuals will only intensify.

The effectiveness of capital markets in supporting pension sustainability as underscored above depends largely on the level of financial market development within a country. The depth, liquidity, breadth of instruments and availability of long-term investment opportunities across numerous sectors are instrumental in determining pension funds' capacity to achieve their required risk-adjusted returns.

For pension assets to reach sustainable long-term outcomes, capital markets must provide exposure to diversified sectors that meaningfully represent the structure of the domestic economy. A well-developed capital market typically includes companies across multiple industries such as financial services, manufacturing, infrastructure, technology, consumer sectors, energy etc. allowing pension funds to allocate capital more efficiently, while maintaining diversification. Sectoral diversity is particularly important for long-term institutional investors, as it reduces concentration risk and improves resilience across economic cycles as investments horizons span for decades.

Market liquidity and depth are equally critical. Deep secondary markets facilitate efficient price discovery and reduce transaction costs, which enable institutional investors to deploy and rebalance large pools of capital without having to absorb large discounts or premiums thus not materially affecting market prices. On the other hand, a vibrant corporate sector that is willing to raise external financing through equity and debt markets further strengthens investment opportunities. In contrast, shallow markets with

limited listings, low free float and weak trading activity constrain portfolio construction and risk management.

In developed markets, total market capitalization often exceeds the GDP. A high market capitalization-to-GDP ratio is often cited as a crude proxy for financial depth, which indicates that capital markets play a substantial role in economic intermediation. Such markets often provide domestic investors with access not only to local firms but also to foreign companies and cross-border investment vehicles, thereby markedly enhancing diversification opportunities for domestic investors. For pension funds with long investment horizons, this breadth significantly improves the ability to construct portfolios closely aligned with their liability profiles.

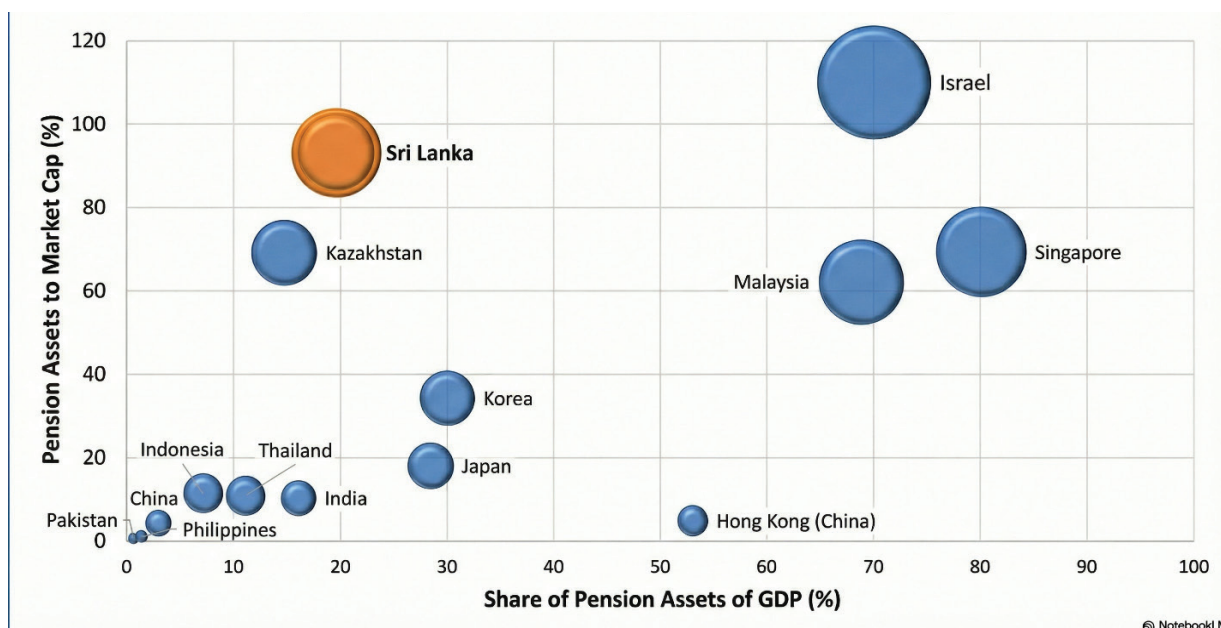
Figure 6 presents the ratio of pension assets to total market capitalization. Sri Lanka stands out, with pension assets accounting for approximately 96% of total market capitalization. This is a notably high concentration relative to the size of its equity market. At the same time, Sri Lanka's pension assets represent merely 18% of GDP. This suggests that the matter is not an excessively large

pension system relative to the economy, but rather a relatively small and shallow capital market. The high pension-assets-to-market-capitalization ratio therefore reflects structural limitations in market size and breadth rather than the relative scale of pension accumulation in the country. In fact, the grid makes it all the more evident that for the scale of share of pension assets to GDP in Sri Lanka, its capital market is disproportionately limited.

Regardless of the market capitalization-to-GDP ratio's improvement over changing recent time, much of the increase has been driven by price appreciation of existing listed equities rather than meaningful expansion in market breadth. There has been very limited growth in new corporate listings, sectoral diversification or expansion of investable instruments. As a result, pension funds operate within a constrained investment universe, increasing concentration risk and limiting portfolio optimization.

In contrast, advanced economies display a more balanced relationship between pension assets and market capitalization. For example, Singapore reports pension assets equivalent to approximately

Figure 6: Pension Asset Depth to Market Capitalization in Asia



80.5% of GDP, while pension assets represent around 69% of market capitalization. Japan reports pension assets of approximately 28.2% of GDP, with pension assets accounting for about 18% of market capitalization. In these cases, the capital markets are sufficiently deep and diversified to absorb sizable pools of long-term institutional capital without necessitating excessive concentration. Yet these countries have heavily diversified their investments geographically across the world, in order to optimize investment returns. High market capitalization relative to GDP, broad sector representation and developed fixed income markets are prerequisites for pension funds, providing diversified opportunities domestically and internationally.

Way Forward

In this context, Sri Lanka's situation highlights a structural imperative as capital market expansion is essential for pension sustainability. The concentration of pension assets within a relatively narrow market increases systemic exposure and reduces the ability to generate diversified long-term returns.

Hence, as a nation Sri Lanka requires policy implications may include but not limited to:

- Encouraging large private corporations to list publicly, thereby expanding the equity universe.
- Gradually bringing commercially viable state-owned enterprises to the capital market through partial listings or public-private structures for debt and equity funding.
- Incentivizing domestic and public sources of capital over private funding and disincentivizing over reliance on banking sector.
- Encouraging the issuance of bonds across benchmark maturities to facilitate the development of a robust and defined yield curve.

- Developing the corporate bond market to provide duration-matching instruments for long-term liabilities and activating institutional participation in the secondary market.

The Largest corporates in the country continue to operate privately, while much of the state sector, despite contributing substantial economic value-addition, remains outside the capital market framework. While this may discredit the economic rationale for becoming a quoted company i.e. to access a broader investor base at relatively cheaper cost, it also reflects structural imbalances in the financial market. Highly concentrated private wealth and easier and cost-effective access to bank credit are often major reasons for lackluster interest in capital market. On the other hand, banks lean toward established, high-quality corporates, because it allows them to maintain a manageable overall credit profile. As a result, credit becomes concentrated among prime borrowers, effectively crowding out SMEs that face greater barriers to accessing financing.

In summary, as Sri Lanka's high pension-assets-to-market-capitalization ratio signals, it is not the excess in the numerator i.e. scale of pension assets, rather the limitations in its denominator i.e. capital market, being underdeveloped, broadening and deepening the domestic capital market is an essential step. Participation from more entities would enhance capital market depth, improve sectoral representation and create a more conducive environment for pension asset allocation. This would help sustain the pension fund's long-term performance while also supporting the broader development of the domestic financial market.

During the preparation of this work, the author used ChatGPT 5.3 in order to improve the language of the Article and to restructure sentences. After using this tool, the author reviewed and edited the content as needed and take full responsibility for the content of the published article.

High Returns, Hidden Risks: Identifying Illegal Finance Schemes

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Introduction

In recent years, the financial landscape has undergone a remarkable transformation, driven by technological innovation, digitalization, and the growing accessibility of financial services. New investment products, online trading platforms, mobile banking applications, digital payment systems, and technology-driven financial solutions have made it easier than ever for individuals to save, invest, borrow, and manage their finances. Financial services that once required physical visits to banks or financial institutions can now be accessed within minutes through smartphones and internet-connected devices.

These developments have created significant opportunities for financial consumers. A wider range of investment options is now available to the public, enabling individuals to diversify their savings and pursue long-term financial goals such as children's education, home ownership, business development, wealth creation, and retirement planning. At the same time, the expansion of digital financial services has improved financial inclusion by extending access to financial products and services to previously underserved communities, including those in rural and remote areas.

The growth of financial literacy initiatives, increased public awareness of investment

opportunities, and the expansion of formal financial markets have also encouraged more people to participate in investment activities. As a result, individuals today have greater opportunities than ever before to build wealth and improve their financial well-being through legitimate investment channels.

However, the same developments that have expanded access to financial services have also created new risks and challenges. The speed at which information spreads through social media and digital communication platforms has enabled fraudulent operators to reach potential investors more easily and on a much larger scale. Unscrupulous individuals and organizations increasingly exploit technology, online marketing, and personal networks to promote unauthorized investment schemes that promise unrealistic returns and quick profits.

During periods of economic uncertainty, rising living costs, inflationary pressures, or low returns on traditional savings products, such offers can appear particularly attractive. Many investors may be tempted by promises of guaranteed returns, exclusive opportunities, or rapid wealth accumulation without fully understanding the associated risks. Unfortunately, experience in Sri Lanka and around the world demonstrates that schemes offering exceptionally high returns with

little or no risk are rarely legitimate and often result in significant financial losses for participants.

What makes illegal finance schemes particularly dangerous is their ability to disguise themselves as legitimate investments. They often rely on persuasive advertising, social media promotions, and personal recommendations from friends, relatives, or colleagues. While these endorsements may be well-intentioned, they can give a false sense of security. When such schemes collapse, the damage extends beyond financial loss, causing emotional distress, damaged relationships, and a loss of trust in the financial system.

Therefore, protecting financial consumers has become a key priority for regulators and policymakers. Public awareness, careful decision-making, and reliance on licensed and regulated financial institutions are essential safeguards. By understanding how genuine investments work and recognizing warning signs early, financial consumers can protect themselves while contributing to a safer and more resilient financial system.

Importance of investment to various parties

Investment plays a vital role in strengthening personal finances, supporting business growth, and driving national economic development. For individuals and families, investing is a practical way to grow savings over time and protect their value against inflation. Thoughtful investment decisions help meet long-term goals such as education, housing, healthcare needs, and income security during retirement. In this sense, investment is a cornerstone of sound personal financial planning.

For businesses, investment enables growth, innovation, and productivity improvements. Funds invested in technology, machinery, research, and skilled workers allow firms to expand operations, remain competitive, and create employment. In Sri Lanka, investment in sectors such as agriculture, manufacturing, tourism, and information technology has played a crucial role in supporting economic activity and livelihoods.

At the financial system level, investment strengthens financial intermediation by channeling savings into productive uses through regulated banks, capital markets, and licensed financial institutions. When savings are placed with supervised institutions, trust in the financial system is enhanced, contributing to stability and resilience.

At a national level, productive investment supports infrastructure development, economic growth, and social progress. Investments in areas such as energy, transport, education, and healthcare improve living standards and long-term development outcomes. When investments flow through legitimate and well-regulated channels, they create a positive cycle of trust, growth, and financial stability that benefits society as a whole.

Factors to consider when choosing an investment

Selecting an appropriate investment requires careful thought and informed judgment. One of the most important principles to understand is the relationship between risk and return. In a nutshell, higher potential returns usually come with higher risks. Therefore, promises of “guaranteed” or “risk-free” high returns should always raise concern, as such claims are inconsistent with how legitimate financial markets operate.

Verifying the legitimacy of the institution or individual offering the investment is essential. In Sri Lanka, financial activities such as banking, finance business, and deposit-taking are regulated by the Central Bank of Sri Lanka, while capital market activities fall under the Securities and Exchange Commission of Sri Lanka. Dealing with licensed and regulated entities provides an important layer of protection for financial consumers.

Transparency is another key factor. Legitimate investments clearly explain how funds are used, how returns are generated, the risks involved, and any fees or conditions for withdrawal. If an investment opportunity avoids clear explanations, discourages questions, or uses complex and vague language, caution is warranted.

Investors should also consider their own financial circumstances, including income stability, savings capacity, and tolerance for risk. Funds needed for short-term expenses or emergencies should not be locked into long-term or illiquid investments. Seeking independent advice from qualified professionals or referring to official guidance issued by regulators can further reduce risk. A disciplined and informed approach remains the foundation of safe investing.

High Returns: The attractive promise

The promise of exceptionally high or guaranteed returns is one of the most commonly used tools by illegal finance schemes. Such offers become especially appealing during periods of economic stress or low interest rates regimes, when traditional savings instruments appear less rewarding.

Promoters often use social media, online advertisements, and testimonials to showcase apparent success stories. Early participants may receive payments that appear to confirm the scheme's credibility. In reality, these payments are frequently funded by money from new investors rather than from genuine investment activities.

Trust is often further strengthened through personal networks. Friends, relatives, colleagues, or members of the same community may recommend the investment in good faith, believing it to be genuine based on their own initial experiences. This personal connection can significantly reduce skepticism and discourage individuals from carrying out proper checks or seeking independent advice. In several cases observed both locally and internationally, such trust-based promotion has resulted in entire communities being affected when schemes fail.

It is important to recognize that in legitimate financial markets, investment returns are shaped by a range of factors, including market conditions, business performance, interest rate movements, and broader economic developments. Even well-managed and regulated investments are subject to fluctuations and periods of lower returns. As a result, no lawful investment can consistently

deliver high, stable, and guaranteed returns without exposing investors to meaningful risks. Regulatory authorities, including the Central Bank of Sri Lanka, have repeatedly warned that promises of unusually high returns with little or no risk are a strong indicator of illegal or fraudulent activity. Financial consumers should therefore treat such promises not as opportunities, but as clear warning signs that require careful scrutiny and caution.

Hidden risks behind the promises

Behind the attractive promises of illegal finance schemes lie serious and often hidden risks. The most significant is the loss of invested capital. Schemes such as Ponzi and pyramid structures depend on continuous inflows of new funds. When these inflows slow or stop, the scheme collapses, leaving most investors with heavy losses.

Unlike financial products of regulated institutions, money invested in illegal schemes typically falls outside the protection of regulatory oversight. This means that investors have no access to compensation mechanisms, deposit insurance, or legal remedies if the scheme fails. Funds collected through these schemes are often misused by promoters, diverted for personal gain, or used merely to pay early investors rather than being channelled into genuine income-generating activities. Such misuse of funds undermines trust in the financial system and highlights why regulation and supervision is critical.

The harm is not only financial. Victims may experience stress, anxiety, and damaged relationships, particularly if money was borrowed or pooled. Social embarrassment may discourage reporting, allowing fraudulent activities to continue. These risks highlight the importance of vigilance and reliance on licensed financial institutions.

Identifying illegal finance schemes

Recognizing illegal finance schemes early is essential to protect investors' money. These schemes often appear attractive by promising quick and high returns, especially during times of rising living costs or low returns on regular savings.

However, they hide serious risks and frequently lead to financial loss.

Key warning signs include promises of guaranteed or unusually high returns with little or no risk, which are unrealistic in genuine financial markets. Another major red flag is pressure to recruit new investors, a common feature of pyramid and Ponzi schemes that rely on new funds to pay earlier participants and eventually collapse. The absence of proper licensing or registration with regulators such as the Central Bank of Sri Lanka or the Securities and Exchange Commission of Sri Lanka is also a strong indicator of illegality.

Fraudsters often use vague or complex explanations, create urgency or secrecy, discourage independent advice, and make it difficult to withdraw invested funds. Regulatory authorities in Sri Lanka have repeatedly warned the public about these schemes and stress the importance of verifying legitimacy before investing. Staying informed, cautious, and alert to these warning signs helps protect personal savings and supports a safer and more trustworthy financial system.

Adverse consequences of illegal finance schemes

Participation in illegal finance schemes can result in severe and long-lasting consequences. Many individuals lose life savings, and some incur heavy debts by borrowing or selling essential assets to invest. Recovery of funds is often difficult or impossible.

In addition to personal financial loss, involvement in illegal schemes can result in legal consequences. Promoters and active participants may be subject to prosecution, fines, or other penalties under Sri Lankan laws such as the Finance Business Act, the Banking Act, or the Financial Transactions Reporting Act. Even those who are not promoters but knowingly participate in unregulated or unauthorized schemes can face scrutiny from law enforcement authorities, highlighting the importance of only dealing with licensed and regulated financial institutions.

The harm caused by illegal finance schemes is not limited to the individual. Families and social

networks are often affected by the stress and tension caused by financial losses. Trust between friends, relatives, and colleagues may be damaged if money invested collectively is lost. Beyond this, the broader economy can also be impacted. Widespread participation in illegal schemes can undermine public confidence in the financial system, discourage legitimate investments, and destabilize the markets by diverting funds away from productive and regulated financial activities. Historical examples in Sri Lanka, as well as in other countries, have shown how large-scale collapses of pyramid and Ponzi schemes not only bankrupt individuals but also shake public trust, prompting stronger regulatory oversight and public awareness campaigns.

Importance of eliminating illegal finance schemes

Eliminating illegal finance schemes is critical not only for protecting individual financial consumers but also for safeguarding the stability and credibility of the broader financial system. These schemes often target individuals and households who may have limited financial knowledge or restricted access to formal banking and investment services. By exploiting such vulnerabilities, illegal schemes can quickly drain personal savings, leaving families in financial distress. Removing such schemes from the financial ecosystem helps prevent exploitation, ensuring that public savings are used safely and productively.

The presence of illegal schemes also undermines trust in legitimate financial institutions. When people lose money to unauthorized or fraudulent operations, they may become wary of investing or saving through regulated banks, finance companies, or licensed investment funds. This reluctance can weaken the flow of capital to productive sectors of the economy, limiting economic growth and job creation. By enforcing the law against illegal finance schemes and promoting financial products of regulated institutions, authorities help ensure that savings are channelled into lawful, productive investments that benefit both individuals and the economy at large.

Promoting an ethical financial culture is a shared responsibility. Regulators, financial institutions, and the public all play a role in preventing the spread of illegal schemes. Public awareness campaigns are essential to educate consumers about the risks of fraudulent schemes, highlighting warning signs and safe investment practices. Strong regulatory enforcement, inter-agency cooperation, and timely reporting of suspicious activities would further strengthen deterrence, making it harder for fraudulent operators to exploit the public.

The Central Bank of Sri Lanka, together with other regulatory and law enforcement agencies, continues to emphasize vigilance and informed decision-making as key tools for financial consumer protection. By understanding the risks of illegal finance schemes, verifying the legitimacy of financial institutions, and making careful investment decisions, financial consumers can protect their own savings while contributing to a safer, more trustworthy, and resilient financial system. Ultimately, the elimination of illegal finance schemes supports not just individual well-being, but also the long-term health and stability of Sri Lanka's financial landscape.

Conclusion

The promise of high returns is naturally appealing, particularly during periods of economic uncertainty, rising living costs, or low interest rates. However, such promises often conceal significant risks that can have devastating consequences for individuals, families, and communities. Experience in Sri Lanka and around the world has repeatedly demonstrated that investment opportunities offering unusually high or guaranteed returns with little or no risk are frequently associated with illegal finance schemes, including Ponzi and pyramid operations, which ultimately collapse and leave investors facing substantial financial losses.

Protecting oneself from such schemes requires awareness, vigilance, and informed decision-making. Financial consumers can reduce their exposure to fraud by understanding the characteristics of legitimate investments,

including transparency regarding the use of funds, appropriate licensing and regulatory oversight, and a realistic relationship between risk and return. Recognizing common warning signs, such as promises of guaranteed profits, pressure to recruit new participants, secrecy surrounding investment activities, and difficulties in withdrawing funds, can help individuals avoid becoming victims of financial fraud. Seeking information from licensed financial institutions, qualified professionals, and official sources such as the Central Bank of Sri Lanka and the Securities and Exchange Commission of Sri Lanka provides an important safeguard against deceptive investment offers.

Prudent investment decisions not only protect personal wealth but also contribute to the strength, stability, and integrity of the broader financial system. When savings are channelled through regulated and productive investment avenues, they support economic growth, business development, employment generation, and long-term national prosperity. In contrast, illegal finance schemes erode public confidence, divert resources away from productive economic activity, and undermine financial stability.

As financial products and investment opportunities continue to evolve, financial literacy remains one of the most effective defenses against fraud. Every investor should remember that legitimate wealth creation is built on informed decisions, realistic expectations, and careful assessment of risk. A simple but enduring principle remains highly relevant: if an investment opportunity appears too good to be true, it most likely is. By exercising caution, conducting proper due diligence, and relying on trusted and regulated financial channels, individuals can protect their financial future while contributing to a safer, more resilient, and more trustworthy financial system for all.

During the preparation of this work, the authors used ChatGPT 5.3 in order to improve the language of the Article and to restructure sentences. After using this tool, the author reviewed and edited the content as needed and take full responsibility for the content of the published article.