

WHY SRI LANKA NEEDS AN EFFICIENT RESOLUTION FRAMEWORK

When a financial institution fails, the consequences extend far beyond its shareholders. Depositors may lose their lifetime savings, creditors may face losses on their investments and businesses dependent on credit or payment services may experience sudden disruptions. The resulting uncertainty can undermine confidence in the financial system as a whole.

In Sri Lanka, banks and finance companies play a central role in financial intermediation, mobilizing savings and extending credit. With deposits in these institutions amounting to over Rs. 20 trillion by mid-2025, the sector holds the financial lifeblood of the economy.

The failure of even a single institution can therefore create ripple effects across the system, eroding depositor trust, restricting access to credit and triggering broader economic instability. Past experiences with distressed finance companies in Sri Lanka have shown that such events can take years to resolve, often leaving depositors and creditors uncertain about recovering their funds. These lessons underscore why managing institutional failures in an orderly and predictable manner is essential to maintaining public confidence.

It is in this context that a resolution framework becomes critically important, providing the legal and operational tools for authorities to intervene early, manage distress and ensure that failures are addressed without destabilizing the financial system or burdening taxpayers.

What is a Resolution Framework

A resolution framework is the mechanism through which the resolution authority manages the failure of a financial institution in a structured and orderly manner. In Sri Lanka, this responsibility is vested in the Central Bank of Sri Lanka (CBSL) under the Central Bank of Sri Lanka Act, No. 16 of 2023 and the Banking (Special Provisions) Act, No. 17 of 2023 (BSPA), which designates the CBSL as the resolution authority for Licensed Banks and Licensed Finance Companies. The framework equips the Central Bank with a range of legal and operational tools to intervene early, restore viability where possible or resolve non-viable institutions in a way that protects depositors, preserves confidence and maintains financial stability without relying solely on taxpayer-funded bailouts. Unlike liquidation, which has often dragged on for years in Sri Lanka and left depositors uncertain about recovery, resolution offers a faster, transparent and consistent process to manage distress while safeguarding the broader financial system.

Why a Resolution Framework Matters

Globally and locally, financial crises have demonstrated that ordinary insolvency procedures are too slow and disruptive for financial institutions and other stakeholders. Once financial consumers lose confidence, the impact can spread rapidly throughout the system. A credible and efficient resolution framework ensures that troubled banks and finance companies can be stabilized, restructured or wound-down in a way that preserves critical functions and services while protecting depositors. It minimises the use of taxpayer funds by allocating losses to shareholders and creditors instead. In short, it prevents the collapse of one institution from spreading into a broader financial crisis.

The Resolution Framework in Sri Lanka

To address the risks posed by failing financial institutions, Sri Lanka has strengthened its financial safety net through the Banking (Special Provisions) Act, No. 17 of 2023. The law empowers the Central Bank to act decisively when Licensed Banks or Licensed Finance Companies show signs of distress. It allows authorities to intervene early, restructure distressed institutions or, when necessary, resolve non-viable firms in an orderly manner that protects depositors, ensures the continuity of critical financial services and preserves overall financial stability.

Under the BSPA, the Central Bank can exercise a range of resolution powers, including appointing an administrator, transferring shares, transferring all or selected assets and liabilities and establishing bridge banks. The framework also provides for coordination with the Government when public funds are required, ensuring that systemic risks are contained without damaging the financial system. By aligning with international standards, the BSPA provides a structured and transparent approach to managing financial distress, reinforcing public confidence in Sri Lanka's financial system.

Lessons from Past Failures

The history of Sri Lanka's financial system provides clear evidence of the importance of a robust resolution framework. The collapse of Pramuka Savings and Development Bank in 2002 and the intervention in

Seylan Bank in 2008 highlighted both the risks of institutional failure and the role of timely action in restoring public confidence. More recently, the failures of several Licensed Finance Companies, including Central Investments and Finance PLC, The Standard Credit Finance Ltd, TKS Finance Ltd, ETI Finance Ltd, The Finance Company PLC, Swarnamahala Financial Services PLC and Bimputh Finance PLC, exposed the shortcomings of lengthy liquidation processes, that left depositors uncertain and waiting for years to recover their funds. These episodes demonstrate that without a credible resolution framework, financial distress can easily undermine trust, disrupt critical services and weaken stability. A structured and efficient approach to resolution is therefore indispensable.

Sri Lanka Deposit Insurance Scheme

Deposit insurance is a widely used mechanism worldwide to safeguard depositors from losses in the event of financial institution failures. It acts as a safety net, protecting small savers, preserving public confidence and supporting overall financial system stability. The importance of such schemes was underscored during the global financial crisis of 2007–2008, after which many countries strengthened their deposit protection systems.

Today, more than 100 jurisdictions operate formal deposit insurance schemes.

In Sri Lanka, the Central Bank introduced a mandatory deposit insurance scheme in 2010 under the Monetary Law Act,

later renamed as the Sri Lanka Deposit Insurance and Liquidity Support Scheme in 2013. With the enactment of the Banking (Special Provisions) Act, No. 17 of 2023, the scheme was formally established as the Sri Lanka Deposit Insurance Scheme (SLDIS).

Coverage of the SLDIS

All licensed commercial banks, licensed specialised banks and licensed finance companies are required to be member institutions of the Sri Lanka Deposit Insurance Scheme. The current coverage limit is Rs. 1.1 million per depositor per institution, applicable to both LKR and foreign currency deposits, inclusive of accrued interest. This provides strong protection for the vast majority of small depositors, with more than 96% of depositors being fully covered.

Depositors' Data as of 30.06.2025			
Description	LFCs	LBs	Total
Value of Total Deposits (Rs. Bn)	1,167	18,900	20,067
Value of Insured Deposits (Rs. Bn)	250	4,869	5,119
Percentage of Insured Deposits	21.5%	25.8%	25.5%
No. of Insured Depositors (in Mn)	3.6	62.3	65.9
No. of Fully Covered Depositors (in Mn)	3.5	60.4	63.9
Percentage of Fully Covered Depositors	95.9%	96.9%	96.9%

Source: SLDIS

However, despite this high depositor coverage, insured deposits account for only about 25% of the total value of deposits, reflecting the large concentration of funds held by a relatively small number of uninsured depositors. It is also important to note that certain deposits, such as interbank deposits and deposits held by Government institutions including Ministries, Departments, Provincial Councils or local authorities are excluded from eligible deposits for compensation under the SLDIS.

The Case for Efficiency

Even with deposit insurance, relying solely on liquidation for unviable finance institutions has proven inadequate, as seen by Sri Lanka's recent experience. In practice, all liquidations in recent years have been handled by a single firm due to the lack of qualified and willing liquidators, a key reason for the lengthy timelines. This concentration not only delays the process but also leaves depositors waiting years to recover their funds, eroding public trust. An efficient resolution framework is therefore essential not just to protect small savers, but also to ensure that failures are managed swiftly and effectively, preserving confidence and safeguarding the stability of the financial system.

Conclusion

The stability of Sri Lanka's financial system is vital, as it safeguards the savings and trust of millions and supports strengthening the economy. While deposit insurance provides essential protection for small savers who hold one fourth of total deposits in the banking and finance sector, it alone cannot address the risks posed by failing financial institutions, especially when liquidation is slow and uncertain. Past failures have shown how lengthy processes erode public confidence. An efficient resolution framework is therefore not optional but essential as it ensures that failures are managed swiftly safeguarding depositors, maintaining confidence and preserving the resilience of the financial system for the future.

