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The Gazette of the Democratic Socialist Republic of Sri Lanka

EXTRAORDINARY

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PART I : SECTION (I) — GENERAL

Central Bank of Sri Lanka Notices

CENTRAL BANK OF SRI LANKA ACT, NO. 16 OF 2023

Rules made under Section 105 read with Section 106(1) and Sections 64(1), and 68(1) of the Central Bank of Sri Lanka Act, No. 16 of 2023.

Dr. P. Nandalal Weerasinghe,
Chairperson of the Governing Board and
Governor of the Central Bank of Sri Lanka.

Central Bank of Sri Lanka,
Colombo,
17th April, 2025.

Criteria for Designating Domestic Systemically Important Banks

1. These Rules shall be cited as the "Criteria used to Designate Domestic Systemically Important Banks Rules No. 01 of 2025".

2. The Governing Board of the Central Bank of Sri Lanka, acting in terms of the provisions of Sections 64(1)(d) read with Section 68(1) of the Central Bank of Sri Lanka Act, No. 16 of 2023 hereby prescribes the criteria for designating Domestic Systemically Important Banks (hereinafter referred to as "D-SIBs") having regard to the guidelines issued by the Basel Committee on Banking Supervision and in order to adopt and apply enhanced macroprudential oversight thereto.

1A- G 44168 - 24 (04/2025)

3. The criteria prescribed under rule 2 are provided for in the ***Schedule*** hereto, which shall be considered part and parcel of these Rules.

4. These Rules shall be applicable to all licensed commercial banks and licensed specialised banks in Sri Lanka (hereinafter referred to as "licensed banks").

5. These Rules shall be effective from 17th April, 2025.

6. For the purposes of these Rules:

(i) "Banking Act" shall mean the Banking Act, No. 30 of 1988 (as amended);

(ii) "Basel Committee on Banking Supervision" shall mean the Basel Committee on Banking Supervision at the Bank for International Settlements, which is the globally accepted body on introducing international standards on Bank Supervision;

(iii) "Central Bank of Sri Lanka Act" shall mean the Central Bank of Sri Lanka Act, No. 16 of 2023;

(iv) "Governing Board" shall mean the decision-making body established under Section 8 of the Central Bank of Sri Lanka Act, No. 16 of 2023;

(v) "Leverage Ratio Exposure Measure" shall mean the Exposure Measure as defined in the Banking Act Directions No. 12 of 2018.

SCHEDULE

CRITERIA FOR DESIGNATING DOMESTIC SYSTEMICALLY IMPORTANT BANKS

1. Introduction

The negative side effects of institutions considered *"too big to fail"* due to their size, complexity, interconnectedness and lack of substitutability are widely acknowledged. Individual financial institutions, in pursuing their own private gains, may make choices that are inefficient on a broader, system-wide scale because they ignore these external effects.

Additionally, the moral hazard created by the expectation of Government support encourages excessive risk-taking, weakens market discipline, distorts competition, and increases the likelihood of future financial trouble. Consequently, the costs of moral hazard compound the direct financial burden that taxpayers might face from such support.

Therefore, the Basel Committee on Banking Supervision (BCBS) has introduced guidelines to reduce the probability of failure of systemically important banks by increasing their going-concern loss-absorbency.

Primary objective of this updated criteria is upscaling the level of surveillance on such banking institutions and to improve resilience of the financial system.

2. Assessment of systemic importance

2.1. The assessment is based on an indicator-driven approach. The chosen indicators capture various factors that could contribute to negative externalities and make a bank crucial for the stability of the financial system.

2.2. The scope of the assessment is applicable for all banks in Sri Lanka, including the branches of foreign banks. Locally incorporated banks are considered on a consolidated basis and foreign bank branches are considered on a standalone basis.

2.3. The criteria consider four categories to assess systemic importance, as follows:
(i) Category (A) - size of the financial institution;
(ii) Category (B) - interconnectedness;
(iii) Category (C) - substitutability/financial institution infrastructure; and
(iv) Category (D) - complexity.

2.4. Except for Category (A), size of the financial institution, there are multiple indicators in each of the other categories, and each indicator is equally weighted within its category, except for the category (D), *i.e.,* complexity. Where cross jurisdictional claims indicator and cross jurisdictional liabilities indicator are together given the weight of a single indicator within the category due to complementary role of the two indicators.

2.5. The indicators considered in the assessment of D-SIBs are given in Table 1 below:

Table 1: Indicators considered in the assessment of D-SIBs

Category (and Weighting)	*Individual Indicator*	*Indicator Weighting*
Size (40%)	Total exposures used in the Leverage Ratio	40.00%
Interconnectedness (20%)	Intra-financial system assets	6.67%
	Intra-financial system liabilities	6.67%
	Securities outstanding	6.67%
Substitutability/ financial institution infrastructure (20%)	Payments activity	6.67%
	Loans (gross) to non-bank customers (excluding Government)	6.67%
	Deposits from non-bank customers (excluding Government)	6.67%
Complexity (20%)	Notional amount of OTC derivatives	6.67%
	Cross jurisdictional claims	3.33%
	Cross jurisdictional liabilities	3.33%
	Trading and available-for-sale securities	6.67%

2.6. For each bank, the score for a particular indicator is calculated by dividing the individual bank's amount by the aggregate amount for the indicator summed across all banks in the sample[1]. This amount is then multiplied by 10,000 to express the indicator score in terms of basis points.

2.7. Each category score for each bank is determined by taking a weighted average of the indicator scores in that category. The overall score for each bank is then calculated by taking a weighted average of its four category scores and then rounding to the nearest whole basis point.

1 See 2.9 for a description of how the sample of banks is determined.

2.8. Categories to assess systemic importance of banks

2.8.1. Category (A) - Size of the bank

A distress or failure of a bank is more likely to harm the economy or financial markets if it represents a significant portion of domestic financial services. The larger the bank, the harder it is for other institutions to quickly take over its functions, increasing the risk of disruption in the markets it operates in. Additionally, the failure of a large bank can undermine confidence in the entire financial system. Therefore, size is a critical factor in determining systemic importance. To measure size, one indicator is used: the total exposures calculated under the Basel III Leverage Ratio.

2.8.2. Category (B) - Interconnectedness

Financial distress at one institution can significantly raise the risk of distress of other financial institutions due to the web of contractual obligations among these institutions. A bank's systemic impact is typically greater if it is highly interconnected with other financial institutions. To measure this interconnectedness, three indicators are used:
(i) Intra-financial system assets;
(ii) Intra-financial system liabilities;
(iii) Securities outstanding.

2.8.3. Category (C) - Substitutability / financial institution infrastructure

The systemic impact of a bank's distress or failure is likely to be higher if it functions as a market player or a service provider that cannot be easily replaced. For instance, if a bank plays a significant role in a specific business area or supports critical infrastructure like payment systems, its failure would likely cause significant gaps in service and a reduction in liquidity. Additionally, customers of a failed bank with a larger market share would face higher costs in finding alternative service providers. Three indicators are used to assess substitutability and financial institution infrastructure:
(i) Payments activity;
(ii) Loans (gross) to non-bank customers (excluding Government);
(iii) Deposits from non-bank customers (excluding Government).

The last two indicators used aim to rank banks based on their respective depositor and borrower base. The more customers, the more difficult it would be to substitute with another bank in the event of distress or failure. Therefore, the reason for excluding the Government's share was to reduce the large influence one bank's customer would have on two or more banks in this category.

2.8.4. Category (D) - Complexity

The systemic impact of a bank's distress or failure is likely to increase with its overall complexity—whether in terms of its business operations, structure, or functions. The more complex the bank is, the greater the time and expense required to manage its resolution. To assess this complexity, four indicators are used:
(i) Notional amount of OTC derivatives;
(ii) Cross jurisdictional claims;
(iii) Cross jurisdictional liabilities;
(iv) Trading and available-for-sale securities.

2.9. Sample of banks

2.9.1. Banks fulfilling any of the following criteria will be included in the sample and will be required to submit the full set of data used in the assessment methodology to the Central Bank of Sri Lanka:
(i) Banks with a Basel III Leverage Ratio Exposure Measure, that exceeds Rs. 500 billion;
(ii) Banks that were previously designated as D-SIBs in the previous year, if necessary; and
(iii) Banks added based on supervisory judgement, if necessary.

2.10. Bucketing approach

2.10.1. Banks with scores that surpass a certain threshold are classified as D-SIBs. However, supervisory discretion may also be applied to include banks with scores below the threshold as D-SIBs.

2.10.2. D-SIBs are allocated into three equally sized buckets based on their scores of systemic importance, with varying levels of higher loss absorbency requirements applied to the different buckets.

2.10.3. In addition to progressing under the normal course of business, the number of D-SIBs and their placement in specific categories will change over time as banks adjust their behaviour in response to the incentives of the D-SIB status and national regulations.

2.10.4. If a bank's score surpasses the highest threshold, additional buckets will be created to accommodate it. These new buckets will be the same size as the existing ones in terms of score range and will come with progressively higher capital requirements, to encourage banks to limit their systemic importance.

2.11. Supervisory judgment

2.11.1. Bank's score may be adjusted based on supervisory judgment. Supervisory judgment is used to override the indicator-based measurement approach in exceptional cases.

2.11.2. In these exceptional cases, the published bucket does not align with the calculated score. The decision to exercise supervisory judgment generally reflects a variety of quantitative or/and qualitative factors not captured in the indicators.

2.12. Ancillary indicators

2.12.1. Ancillary indicators are considered relating to specific aspect of the systemic importance of the bank that may not be captured by the indicator-based measurement approach alone. These indicators are used to support the judgement overlay.

2.13. Periodic review and refinement

2.13.1. The methodology, including the indicator-driven approach itself, the cutoff/threshold scores and the size of the sample of banks, will be reviewed once in three years to incorporate any revisions or amendments in accordance with BCBS reviews.

2.14. Operational timeline

2.14.1. The criteria are to be effective from 17th April 2025 and going forward, D-SIBs assessment will be conducted by the Central Bank of Sri Lanka based on below timelines:

Table 2: Timeline for implementation

Time	Task
April	Collect data from the selected banks in the sample (Annually)
August	Assess collected data and identify the D-SIBs (Annually)
October	Publish the list of D-SIBs with the approval of the Governing Board (In three-year intervals or as decided by the Governing Board)

2.15. For the purposes of the criteria specified in this Schedule,

(i) "Indicator-Driven Approach" shall mean the methodology utilised by the Basel Committee on Banking Supervision for assessing the systemic importance of Global Systemically Important Banks. The selected indicators are chosen to reflect the different aspects of what generates negative externalities and makes a bank critical for the stability of the financial system.

(ii) "Leverage Ratio" shall mean the Leverage Ratio as defined in the Banking Act Directions No. 12 of 2018.

(iii) "Higher Loss Absorbency Requirement" shall have the same meaning as set out in Global Systemically Important Banks: Revised Assessment Methodology and the Higher Loss Absorbency Requirement published by the Basel Committee on Banking Supervision (July 2018).

(iv) "Intra-financial System Assets" shall mean the sum of funds deposited with or lent to other financial institutions (including unused portion of committed lines extended), holdings of securities issued by other financial institutions, net positive current exposure of securities financing transactions (SFTs) with other financial institutions, and over the counter (OTC) derivatives with other financial institutions that have a net positive mark to market value.

(v) "Intra-financial System Liabilities" shall mean the sum of funds deposited by or borrowed from other financial institutions (including unused portion of committed lines obtained), net negative current exposure of securities financing transactions (SFTs) with other financial institutions, and over the counter (OTC) derivatives with other financial institutions that have a net negative mark to market value.

(vi) "Notional Amount of OTC Derivatives" shall mean the Notional Amount of Over the Counter (OTC) Derivatives as defined in the Banking Act Direction No. 02 of 2025 on Domestic Systemically Important Banks.

(vii) "Cross Jurisdictional Claims" shall mean Cross Jurisdictional Claims as defined in the Banking Act Direction No. 02 of 2025 on Domestic Systemically Important Banks.

(viii) "Cross Jurisdictional Liabilities" shall mean Cross Jurisdictional Liabilities as defined in the Banking Act Direction No. 02 of 2025 on Domestic Systemically Important Banks.

(ix) "Trading and Available-for-Sale Securities" shall mean Trading and Available-for-Sale Securities as defined in the Banking Act Direction No. 02 of 2025 on Domestic Systemically Important Banks.

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