Macroprudential Surveillance

The 2008 global financial crisis proved the fact that a stress in one institution can spread quickly to related institutions, across sectors and across juris creating systemic issues. The global financial crisis and subsequent developments related to it showed that microprudential supervision alone was not e sustain the stability of the financial system. Accordingly, the CBSL recognizes the importance of a more comprehensive macroprudential approach, wh beyond supervision at the individual firm level to look at broad market and economic factors that could have a material impact on the overall financia stability of the country.

The evolving organisational structure of the CBSL has reflected its explicit commitment towards institutionalizing a comprehensive macroprudential surve framework. Well before the global financial crisis, in May 2006, the CBSL set up a Financial Stability Unit (FSU) with a broad mandate of, *inter alia*, asses risks and vulnerabilities that may lead to major instabilities or imbalances in the financial system in the foreseeable future as and when those are identifi recommending policies necessary to address issues relating to such instabilities. Later in August 2006, the FSU was upgraded to a separate department clear focus on macroprudential surveillance.

The macroprudential surveillance framework of the CBSL has been evolving to ensure wider coverage of different sources of systemic risk. The framewor depends on a wide range of data representing flow-of-funds, financial prices, monetary data, external financial data, and macroeconomic data together wi banking/financial structures and qualitative information. The assessments so made are reflected in the following formats:

(a) Financial Stability Indicators and Maps

Financial Stability Indicators and Maps represent corresponding indicators of systemic stress in the financial system relative to a base year. Curren are three segmental indicators namely, the Financial Markets Stability Indicator (FMSI), the Banking Soundness Indicator (BSI), and Licensed Companies Soundness Indicator (LFCSI). These three indicators are constructed based on contemporaneous developments in a number of risk/ factors relevant to financial stability from different segments of the financial system i.e. financial markets, banking sector, non-bank financial ins sector, and the macro-economy, and statistically condensing the information in a single statistic which measures the current state of stability in eac three segments mentioned above. The Financial System Stability Index (FSSI) is the composite indicator derived using FMSI, BSI and LFCSI. The I Financial Stability Map depict the overall stability condition of the financial system. The Financial Stress Index (FSI), a new stability indicator, was d in 2020 to identify periods when strains on the financial system impair its intermediation function. This index combines indicators from the equities bond market, foreign exchange market and banking sector into a composite index to assess the degree of stress in the financial system.

(b) Solvency Stress Testing

Macroprudential Surveillance Department (MSD) conducts the semi-annual solvency stress testing exercise on the banking sector which charact dynamic top-down stress testing. The exercise entails assessing the resilience of the banking sector under two hypothesized macro-financial scena Baseline scenario and Adverse scenario. Results of the stress testing exercise is communicated to the Monetary Board at regular intervals.

(c) Interconnectedness and Contagion Analysis

Interconnected and contagion analysis primarily focuses on the risks towards the banking system through interbank exposures and extends to as contagion risks emanating from the State-Owned Entities and License Finance Companies while factoring solvency and liquidity channels in the mode

(d) Liquidity Stress Testing

The cash-flow stress testing assesses banks' resilience to liquidity risk based on net cash balances following the funding outflow shock. The stress simulates an episode of intense liquidity pressure typically observed during liquidity crises. The cash flow stress testing allows for an intuitive view banks' liquidity risk bearing capacity in the form of the cumulated counterbalancing capacity at each maturity bucket.

(e) Systematic Risk Survey

MSD conducts the Systemic Risk Survey (SRS) on a biannual basis since 2017. SRS is a forward-looking survey which quantifies and tracks participants' perceptions on the potential risks to financial system stability signaling any build-up of systemic vulnerabilities and perceived probab high impact event. Materialisation of these risks could potentially disrupt the financial intermediation process and affect the public confidence financial system stability. Further, SRS helps to validate the internal assessments of MSD on vulnerabilities of the financial system.

(f) Periodical risk assessments

MSD prepares Quarterly Risk Assessment (QRA) which highlight the financial sector risks and resilience on a quarterly basis. The QRA is submitte information of the Monetary Board via Financial System Stability Committee (FSSC).

(g) Financial System Stability Review

MSD annually publishes the Financial System Stability Review (FSSR) for the scrutiny of all the concerned stakeholders. FSSR analyses risk and re the financial system under five chapters namely, Macro-financial Conditions, Financial Markets, Financial Institutions, Corporate and Household Se

Financial Infrastructure.

(h) Household and Corporate Sector Analysis

MSD conducts analysis on Corporate Sector and Household Sector to assess the financial vulnerabilities emanating from the two sector vulnerabilities of the Corporate sector are analysed to assess risks emanating from Non-Financial Cooperates (NFCs) to the financial system on basis, using information on listed NFCs in the Colombo Stock Exchange which serves as a proxy for the NFCs. In addition, MSD analyses the indel of the Household and Institutional sectors to assess the financial vulnerabilities emanating from such borrowers and identify possible buildup of risks. The analysis is carried out based on the quarterly aggregate credit data of the banks and LFCs/SLCs sector received from the Credit Inf Bureau (CRIB).

(i) Sustainable Financing

MSD functions as the secretariat for the Implementation of the Roadmap for Sustainable Finance in Sri Lanka and is engaged in coordinating stakeholder groups who have interest in promoting sustainable financing initiatives in the country.