

Guidelines on Incorporating a Framework to Implement Key Pillars: Sustainable Development Goals (SDGs), Environmental, Social, & Governance (ESG) Principles and Sustainable Finance, Initiatives in the Insurance Industry

1. Introduction

- 1.1 The Insurance Regulatory Commission of Sri Lanka (IRCSL), in its commitment to fostering sustainable development and promoting a resilient and responsible insurance ecosystem, issues these guidelines to support the integration of Sustainable Development Goals (SDGs), Environmental, Social, & Governance (ESG) Principles and Sustainable Finance Initiatives within the insurance industry. These guidelines aim to ensure effective governance, the establishment of comprehensive risk management frameworks, and alignment with global best practices to drive sustainability and accountability in the sector
- 1.2 This guideline aligns with the broader vision outlined in the Central Bank of Sri Lanka's (CBSL) Roadmap for Sustainable Finance, published in 2025. The CBSL Roadmap supports the country's transition towards a green, inclusive, and balanced economy while addressing the United Nations Sustainable Development Goals (SDGs). It provides strategic guidance for financial institutions and regulators to manage ESG risks and promote climate-resilient, socially inclusive businesses.

2. Empowerment

- 2.1 The IRCSL issues these guidelines to foster sustainability within the insurance industry while contributing to the nation's sustainable development goals. This aligns with national requirements to promote responsible and sustainable practices across the sector.

3. Applicability

- 3.1 These guidelines are applicable to all registered and licensed long term and general insurance companies in Sri Lanka

4. Purpose and Objectives

4.1 Purpose

- 4.1.1 To establish a comprehensive regulatory framework that encourages insurance companies to integrate sustainability into their core business strategies by aligning with the United Nations Sustainable Development Goals (SDGs), adhering to environmental, social, and governance (ESG) principles and promoting sustainable finance initiatives. This framework aims to foster long-term resilience, drive innovation in sustainable insurance solutions, and create a positive social and environmental impact while ensuring the stability and growth of the insurance sector.

4.2 Objectives

- 4.2.1 Encourage insurance companies to integrate sustainable finance principles into their business operations, fostering long-term resilience, inclusivity, and growth.
- 4.2.2 Strengthen accountability and transparency within the insurance sector through the implementation of robust ESG reporting frameworks.

5. Key Pillars of the Framework

5.1 Insurance companies shall develop appropriate internal guidelines to conduct their business activities sustainably, covering the following key pillars:

5.1 Pillar 1: Alignment with SDGs

Insurance companies shall focus on supporting the following nine (09) Sustainable Development Goals (SDGs), which represent areas, where the insurance sector can have the most significant impact:

- (a) SDG 1: No Poverty
Provide micro insurance and inclusive financial products to reduce vulnerability to economic shocks and enhance financial security.
- (b) SDG 3: Good Health and Well-being
Develop health insurance products to improve access to healthcare and promote wellness.
- (c) SDG 5: Gender Equality
Promote gender-sensitive insurance products and support women's economic empowerment through tailored insurance solutions.
- (d) SDG 7: Affordable and Clean Energy
Support investments and insurance solutions for renewable energy projects, facilitating the transition to clean energy.
- (e) SDG 8: Decent Work and Economic Growth
Encourage sustainable economic development by insuring businesses, fostering job creation, and supporting SMEs.
- (f) SDG 9: Industry, Innovation, and Infrastructure
Insure infrastructure projects that promote resilience and innovation, contributing to sustainable urban and industrial development.
- (g) SDG 11: Sustainable Cities and Communities
Provide disaster risk insurance and solutions to address challenges like climate change and natural disasters.
- (h) SDG 13: Climate Action
Support climate risk mitigation and adaptation by offering products that address climate-related risks.
- (i) SDG 17: Partnerships for the Goals
Foster collaborations with stakeholders, including governments, NGOs, and private entities, to accelerate progress on sustainable development initiatives.

Products and activities related to the above Sustainable Development Goals (SDGs) are detailed in Annexure 2.

5.1.1 Identified Priority Sectors

The following sectors and activities are identified as priority areas for providing sustainable insurance solutions /green insurance policies that support sustainable growth in line with SDGs:

Identified Sectors	Prioritized Focus-Sectors
Agriculture, Forestry, and Logging	<ul style="list-style-type: none">• Sustainable agriculture and forestry development.• Promote sustainable farming practices.• Provide support for climate-resilient crops.
Manufacturing	<ul style="list-style-type: none">• Energy-saving machinery and equipment.• Facilitate adoption of cleaner production technologies.

Electric Power Generation	<ul style="list-style-type: none"> Renewable energy projects. Invest in renewable energy projects such as solar, wind, and hydropower. Support energy efficiency programs.
Transportation and Storage	<ul style="list-style-type: none"> Sustainable transport and storage solutions. Invest in green transportation infrastructure. Encourage electric vehicle adoption.
Water Supply, Sewerage, and Waste Management	<ul style="list-style-type: none"> Water supply/management projects, waste management Promote waste management systems.
Construction	<ul style="list-style-type: none"> Green construction projects Support green building certifications. Provide coverage for renewable energy projects and eco-friendly construction.
Sustainable Tourism and Recreation	<ul style="list-style-type: none"> Sustainable tourism and recreational activities
Other Sectors	<ul style="list-style-type: none"> Gas, steam, air conditioning supply, financial services, ICT, sustainable women empowerment initiatives, etc.

5.2 Pillar 2: ESG Integration in Insurance

5.2.1 Insurance companies shall integrate Environmental, Social, and Governance (ESG) principles into all aspects of their operations.

5.2.2 Insurance companies shall identify non-financial risks and opportunities related to ESG factors and ensure that they develop appropriate strategies to manage or mitigate ESG risks. Annexure 3 summarizes and provides examples of ESG factors.

5.2.3 Insurance companies shall focus on the following key areas for ESG integration:

- Establish ESG objectives and set measurable goals to manage risks, reduce costs, and enhance operational efficiency, targeting net-zero emissions.
- Develop methodologies for assessing ESG risks
- Leverage technology to encourage policyholders to reduce risks and adopt sustainable behaviors.
- Embed ESG elements into existing models to help policyholders better understand and manage their risks.
- Enhance public understanding of sustainable/green insurance products and financial literacy.
- Advocate for workforce diversity and gender equality within the insurance sector.

5.3 Pillar 3: Sustainable Finance Implementation

5.3.1 Sustainable finance refers to financial activities, investments, and insurance solutions that aim to reduce net carbon emissions over the lifecycle of a project. It also includes supporting indirect activities, such as sustainable manufacturing processes and innovations, that contribute to climate adaptation, environmental protection, and the transition to a low-carbon, resilient economy.

5.3.2 As Sri Lanka progresses toward sustainable economic development, the insurance sector holds a crucial role in promoting Sustainable finance initiatives.

5.3.3 Insurance companies are expected to actively contribute to climate resilience, environmental protection, and sustainable growth by aligning their corporate affairs and product offerings with Sustainable finance objectives. These objectives include;

- Promoting renewable energy

- (b) Clean transportation
- (c) Access to clean energy
- (d) Climate-resilient infrastructure
- (e) Conserving forests and critical ecosystems
- (f) Enhancing social/financial inclusiveness

5.3.4 Insurance companies are encouraged to align their products with these objectives in supporting Sri Lanka's transition toward sustainable development. As such, the insurers shall,

- (a) Prioritize the introduction of insurance solutions for priority sectors stated in **sec 5.1.1** that are important in achieving environmental sustainability. Special insurance packages with preferential terms, such as affordable premiums or tailored coverage, shall be offered to businesses and projects in these sectors to encourage adoption and investment in environmentally sustainable activities.
- (b) Initially introduce insurance solutions for priority sectors, gradually expanding to more advanced climate-related insurance products. This phased approach may include:
 - i. **Phase 1:** Focus on basic insurance coverage (Sustainable/green insurance policies) for priority sectors as outlined in section 5.3.4 (a).
 - ii. **Phase 2:** Develop specialized climate risk products, such as coverage for losses due to natural disasters (floods, droughts, and landslides) and products promoting clean technologies, carbon capture, and biodiversity conservation.
 - iii. **Phase 3:** Introduce innovative insurance solutions for the agriculture sector and for disaster recovery. (e.g. index-based insurance, parametric insurance)
- (c) Offer incentives to clients adopting Sustainable green practices to promote environmental sustainability,
- (d) Engage with development partners, policymakers, and financial institutions to identify the unique insurance needs of priority sectors. Collaboration may include:
 - i. Partnering with renewable energy companies to design specific insurance solutions for solar and wind installations.
 - ii. Supporting sustainable agriculture by offering crop insurance solutions that promote climate resilience.
- (e) Educate businesses and the public about the availability and benefits of Sustainable/green insurance products, as well as their role in supporting national sustainability goals.
- (f) Capacity-building initiatives for internal staff and industry stakeholders shall also be undertaken to strengthen expertise in underwriting green risks.
- (g) Integrate the applicable environmental, climate adaptation and mitigation aspects, social impact considerations, regulations, and external/internal guidelines into their underwriting practices.
- (h) Explore alternate insurance schemes tailored to the needs of the poorest households and Micro Small & Medium Enterprises (MSMEs) to ensure financial inclusion.
- (i) Work with development partners, industry associations, and networks to leverage expertise and resources for capacity-building initiatives.
- (j) Establish mechanisms to monitor and report the adoption and performance of Sustainable/green insurance policies, highlighting their contribution to environmental sustainability

- 5.1.1 The Board of Directors (BOD) and senior management of insurance companies shall oversee the integration of sustainable practices into business operations.
- 5.1.2 Insurance companies shall develop a Board-approved Sustainable Finance Policy, which shall, at a minimum, include:
 - (a) Clear roles and responsibilities of the BOD and senior management in overseeing environmental, social, and sustainable business activities.
 - (b) Identification of key environmental and climate-related risks relevant to the insurance company.
 - (c) Integration of sustainable finance activities and environmental risks into the company's overall risk management framework.
 - (d) Policies and processes for assessing, monitoring, reviewing, and reporting on these risks.
 - (e) Internal controls to ensure compliance and accountability.
 - (f) Appoint a key individual responsible for driving the sustainable finance initiative within the company.

5.2 Roles of the Principal Officer and Key Management Personnel:

- 5.2.1 Under the guidance of the BOD, the Principal Officer and the relevant senior management staff shall;
 - (a) Regularly review and update policies, tools, metrics, operational procedures, and controls related to sustainable finance.
 - (b) Ensure adequate resources, skills, and expertise are available for managing sustainable finance initiatives.
 - (c) Clearly define the roles and responsibilities of the personnel in managing risks associated with sustainable finance.
 - (d) Inform the BOD promptly about any significant issues related to sustainable financing and business practices.

5.3 Risk Management

- 5.3.1 Insurance companies shall identify and evaluate risks arising from climate, environmental, and other Sustainable financing activities. These risks should be assessed based on the nature, scale, complexity, and interconnectedness of operations. The magnitude and materiality of such risks must also be considered.
- 5.3.2 Insurers shall incorporate **ESG risk management** into their decision-making processes. The following measures are recommended:
 - (a) All material risks, as defined under the Risk-Based Capital (RBC) framework, should be assessed, including their potential impact on the business model.
 - (b) Insurers are encouraged to conduct scenario analysis and stress testing to evaluate potential risks related to climate change and Sustainable financing activities.
 - (c) Effective risk management practices and internal controls should be implemented to mitigate identified risks.

5.4 Capacity Building and Innovation

5.4.1 To support sustainable finance activities, insurance companies shall invest in capacity building and foster innovation. The following actions are expected:

- (a) Conduct a gap analysis to identify areas where operations can contribute to specific SDGs.
- (b) Provide adequate training for staff to enhance understanding and expertise in sustainable finance activities.
- (c) Develop innovative and customer-centric sustainable insurance solutions tailored to market needs.
- (d) Build expertise in conducting environmental stress testing and scenario analysis, leveraging external expertise, where necessary to address climate and environmental risks.

6. Disclosures and Reporting

6.1 Registered insurance companies shall disclose the following information related to sustainable practices in their annual reports and or websites:

- (a) A statement on the company's approach to sustainable activities and its strategic direction for future initiatives, including company's sustainable policies & activities within the insurance sector in relation to SDGs stated in Pillar 1 (Sec. 5.1), and implementation of Sustainable Finance initiatives stated in Pillar 3 (Sec. 5.3).
- (b) Identified risks related to sustainability and associated mitigation measures adopted by the company in relation to ESG in Pillar 2 (Sec.5.2).
- (c) Encouraged to disclose the environmental and social impact generated from their business activities using internationally recognized reporting frameworks, such as the Global Reporting Initiative (GRI) and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and IFRS Sustainability Disclosure Standards (SLFRS S1 and S2) in relation to ESG in Pillar 2 (Sec.5.2).

6.2 Submission Requirements

6.2.1 Insurance companies shall establish mechanisms to monitor and report on the adoption and performance of sustainable/green insurance policies, highlighting their contribution to environmental sustainability.

6.2.2 Insurance companies shall submit the required information annually as per **Annexure VI** to the IRCSL within 30 days from the end of each year.

7. Role of the Insurance Regulatory Commission of Sri Lanka (IRCSL) in Scaling Up Action on Sustainable Finance in Sri Lanka: Sustainable Finance Roadmap 2.0 Framework 2025-2029

7.1 The implementation of sustainable finance is a key national priority. As part of the roadmap for 2025- 2029, the Insurance Regulatory Commission of Sri Lanka (IRCSL) will play a key role in supporting the insurance industry to adopt sustainable finance practices. With the collaboration of the International Finance Corporation (IFC) and the Central Bank of Sri Lanka (CBSL), this

roadmap aims to drive systemic change, empowering the industry to transition towards sustainable finance and integrate ESG (Environmental, Social, and Governance) factors into its operations.

7.2 IRCSL will support the industry to drive sustainable finance in the following ways:

- (a) Conduct training sessions for insurance professionals to enhance their understanding of SDGs, ESG risk management, sustainable finance principles, etc. with external expertise.
- (b) Support the insurance industry's initiatives in sustainable/green insurance products by partnering with government bodies, development partners, NGOs, and other international organizations.
- (c) Initiate discussion with the insurance industry to identify areas related to sustainable/green insurance products that require tax relief.
- (d) Meet the industry working group quarterly to discuss progress.

8. Effective Date

The guideline shall be complied with by all insurance companies registered to carry on insurance business (long- term and general) with immediate effect.

ANNEXURES

- I. Action Plan 2025-2029
- II. List of Products and Activities under SDGs
- III. Key ESG factors
- IV. Key Definitions
- V. Related Links
- VI. Templates for ESG and SDG Reporting
- VII. Sustainable Finance Roadmap 2.0 - <https://search.app/gwyx6JQAyv2DXA52A>

Annexure I

Action Plan 2025-2029

Action Plan 2025-2029								
No.	Objective	Action Items	Responsibility	2025	2026	2027	2028	2029
1	Develop the regulatory and policy framework on sustainable insurance.	(a) Issuing the guideline on SDG, ESG & Green Finance	IRCSL					
		(b) Submit the guideline to the commission for their observations						
		(c) Insurance industry consultation						
		(d) Obtain Commission approval for the guideline						
		(e) Issuing the guideline for the industry						
		(f) Form a Working Group for implementing Sustainable Insurance practices (WGSI)	IASL		●	●		
		(g) Organize workshops on sustainable finance initiatives /insurance with external expertise (with support from relevant development partners/ network/resources)	IRCSL & External Resources		●	●		
		(h) Develop company-specific guidelines internally	Insurance companies					
2	Improve the Green Finance Taxonomy	(a) Conduct a scoping /industry-wide study on the adoption of the Green Finance Taxonomy to identify the issues & gaps encountered and suitable environmental insurance products.	IRCSL (lead), WGSI				●	
		(b) Discussion with the industry working group regarding the relevancy & applicability of DNSH and minimum safeguards, with a view to improving the Green Finance taxonomy	IRCSL (lead), WGSI				●	

3	Support the capacity of FIs in adopting reporting and disclosure practices aligned with international standards	(a) Facilitate the capacity building of Insurance companies on the implementation of SLFRS S1 and S2 standards with the support of CA Sri Lanka (with support from relevant development partners/network/resources) (b) Conduct capacity building of Insurance companies on E&S disclosure sustainable finance strategies and E&S data at corporate or asset level on regular basis to further improve Green Taxonomy (with support from relevant development partners/network/resources) (c) Develop standardized template to disclose the requirements under item 3(a) & 3(b) and issue guidelines, where applicable.	IRCSL (lead), WGSI & External Resources				
4	Develop the regulatory and policy framework on sustainable insurance	(a) Develop a disaster risk strategy for insurance sector with the support of external consultancy (with support from relevant development partners/network/resources) (b) Prepare regulations on inclusive insurance against natural risks with the support of external consultancy (with support from relevant partners/network/resources)	IRCSL (lead), WGSI & External Resources				

NOTE:

1. Members of the WGSI to meet on a monthly basis to discuss progress within the industry.
2. Members of the WGSI to meet the sustainable officers of insurance companies on a monthly basis to discuss the progress and further improvements, if any.
3. Members of the WGSI to meet IRCSL on a quarterly basis to apprise the progress and actions taken to implement sustainable finance initiatives

Annexure II

List of Products and Activities under SDGs

SDGs	Why this relevant	Insurance Solutions
	<ul style="list-style-type: none"> Insurance provides a safety net for those using it, preventing families from falling (back) into poverty after experiencing a shock. Insurance provides an economic protection mechanism for all. Insurance sustains other development efforts. 	<p>Covers:</p> <ul style="list-style-type: none"> micro insurance <p>Services:</p> <p>Financial Literacy Workshops: Programs designed to educate low-income populations on managing finances and understanding insurance products.</p> <p>CSR Projects:</p> <p>Community Financial Education Initiatives: Collaborations with local NGOs to provide financial literacy training and resources to empower low-income communities.</p>

<p>3 GOOD HEALTH AND WELL-BEING</p> 	<ul style="list-style-type: none"> • Insurance and social protection can play complementary roles to cover a range of household health care costs. • Insurance improves healthcare seeking behavior. 	<p>Covers:</p> <ul style="list-style-type: none"> ▪ critical illness insurance ▪ long-term care insurance (or nursing home insurance) ▪ longevity insurance (pension/annuity) ▪ health insurance (public and/or private) ▪ include hospital cash plans and community-based insurance <p>Services:</p> <p>Telemedicine Services: Offering remote consultations and health management services to improve access to healthcare.</p> <p>CSR Projects:</p> <p>Health Awareness Campaigns: Initiatives to educate communities about preventive healthcare practices and available health insurance options.</p>
<p>5 GENDER EQUALITY</p> 	<ul style="list-style-type: none"> • There are gender differences in risks faced by women and men. • Insurance offers protection for women working in the informal sector who often fall outside the reach of public social protection schemes. • Insurance Protects women against the devastating effects of gender-related reproductive health risks. • Insurance Protects women from the financial impact of losing family members, helping women to retain their homes, sustain their businesses, continue education of their children, and generally maintain the financial stability of their household. 	<p>Covers:</p> <ul style="list-style-type: none"> ▪ Women Empowerment Insurance: Tailored insurance products that provide coverage for women entrepreneurs, working women including maternity benefits and business-related risks. ▪ Women's Health Insurance <p>Services:</p> <p>Financial Advisory Services for Women: Specialized advisory services that help women navigate financial products and entrepreneurship.</p> <p>CSR Projects:</p> <p>Women's Entrepreneurship Training Programs: Workshops aimed at empowering women with skills and knowledge to start and manage their businesses.</p>

7 AFFORDABLE AND CLEAN ENERGY 	<ul style="list-style-type: none"> Insurance protects renewable energy projects (e.g., solar, wind) from financial losses caused by natural disasters, equipment failures, or delays. Insurance enables access to loans and funds by reducing risks for investors in clean energy initiatives. Insurance incentivizes businesses and individuals to transition to renewable energy by offering tailored coverage and reduced premiums for sustainable practices. 	<p>Covers:</p> <ul style="list-style-type: none"> Renewable Energy Project Insurance <p>Services:</p> <p>Energy Efficiency Consulting: Services that help businesses and households improve energy efficiency and reduce costs.</p> <p>CSR Projects:</p> <p>Community Clean Energy Initiatives: Partnerships with NGOs to promote the adoption of clean energy solutions in rural areas through education and financial support.</p>
8 DECENT WORK AND ECONOMIC GROWTH 	<ul style="list-style-type: none"> Insurance protects assets, thereby unlocking loans and other funds for investments by MSMEs. Insurance frees MSME's private funds for productive investment. Insurance supports the development of MSMEs by protecting them from losses due to risks related to business, natural disasters or other catastrophes. 	<p>Covers:</p> <ul style="list-style-type: none"> SME Growth Insurance: Insurance products designed to protect small and medium enterprises against operational risks and business interruptions. <p>Services:</p> <p>Business Development Support Services: Consulting services that assist SMEs in optimizing operations and accessing financial resources.</p> <p>CSR Projects:</p> <p>Entrepreneurship Incubation Programs: Initiatives that provide mentorship, training, and resources to aspiring entrepreneurs.</p>
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 	<ul style="list-style-type: none"> Insurance helps to increase the access of small-scale industrial and other enterprises to financial services, including affordable credit, and their integration into value chains and markets. 	<p>Covers:</p> <ul style="list-style-type: none"> cyber insurance commercial property and asset insurance product liability cover <p>Services:</p> <p>Risk Assessment Services for Infrastructure Projects: Consulting services that evaluate risks and recommend mitigation strategies for infrastructure investments.</p> <p>CSR Projects:</p>

		Community Infrastructure Development Projects: Collaborations with local governments to enhance infrastructure resilience through community engagement.
 11 SUSTAINABLE CITIES AND COMMUNITIES	<ul style="list-style-type: none"> Insurance makes human settlements more resilient. Property covers help to retain investments of individuals, businesses, local and national governments. Economic disparities, which often lead to safety concerns, can be exacerbated by a lack of insurance pushing people further into poverty. Effective resilience requires some external risk diversification which is a core reason for insurers. 	<p>Covers:</p> <ul style="list-style-type: none"> Compulsory motor insurance Disaster risk mitigation Appropriate property and vehicle cover. <p>Services:</p> <p>Disaster Preparedness Training: Services that educate communities on disaster risk management and preparedness strategies.</p> <p>CSR Projects:</p> <p>Community Disaster Response Initiatives: Programs that provide resources and training for communities to effectively respond to natural disasters</p>
 13 CLIMATE ACTION	<ul style="list-style-type: none"> Insurance mitigates the effects of extreme weather events, thereby strengthening climate change resilience. Insurance complements and strengthens other climate change coping efforts. Catastrophe insurance protects a variety of stakeholders, from companies and infrastructure to the most vulnerable. Indemnity insurance compensates the insured for the loss or damage of a physical asset Parametric insurance offers coverage to respond to extreme weather events and natural catastrophes-The parameters could refer to wind speed or rainfall volume over defined timeframes and in specific locations 	<p>Covers:</p> <ul style="list-style-type: none"> Coral reef and beach insurance Forest restoration resilient bonds Flooding risks acquire parametric or indemnity insurance contracts climate risk insurance Green insurance for motor vehicles- Pay-As-You-Drive insurance Green Insurance Initiatives <ul style="list-style-type: none"> Green insurance for businesses Green insurance for buildings and homes Catastrophe insurance Index-based insurance Environmental liability insurance

		<ul style="list-style-type: none"> ▪ Emission Reduction and Carbon Offset Insurance ▪ warranty insurance for solar panels and wind turbines ▪ geothermal exploration risks insurance ▪ Insurance for hybrid and electric vehicles ▪ save-as-you-sail (Low-emission shipping) ▪ earthquake and other disaster insurance <p>Services:</p> <p>Climate Adaptation Consulting: Services that guide businesses on strategies to adapt to climate-related risks.</p> <p>CSR Projects:</p> <p>Environmental Sustainability Campaigns: Initiatives focused on raising awareness about climate change and promoting sustainable practices within communities.</p>
 <p>17 PARTNERSHIPS FOR THE GOALS</p>	<ul style="list-style-type: none"> • The positioning of insurance within the global development agenda is important. • This involves integrating insurance within stakeholder engagement and profiling best practices during engagement in the global partnership for sustainable development. 	<p>Partnership Development Programs: Insurance products that facilitate collaborations between stakeholders for sustainable development initiatives.</p> <p>Services:</p> <p>Stakeholder Engagement Services: Consulting services that help organizations build partnerships for shared goals.</p> <p>CSR Projects:</p> <p>Collaborative Community Development Projects: Joint ventures with governments and NGOs to implement community-focused development initiatives.</p>

Source: Policy Note a_2ii

Annexure III

Key ESG factors

	<h4>Environmental</h4> <p>Businesses rely on natural resources and physical assets to perform their operations. Products and services may directly or indirectly impact the environment.</p> <ul style="list-style-type: none">• Climate change• Carbon management• Resource depletion• Pollution• Energy consumption• Land use• Loss of biodiversity• Water consumption• Waste management• Innovations or products or services that reduce environmental impact
	<h4>Social</h4> <p>To conduct their operations, companies harness the talent and skills of their employees. Products and services, and operating activities involved in production, may benefit society or cause harm.</p> <ul style="list-style-type: none">• Job creation and working conditions• Equal opportunity• Diversity• Training• Impacts on local communities• Health and safety• Child and forced labor across supply chains• Grievance mechanisms• Human rights• Social impact of products, services, or company operations• Gender-based violence and harassment
	<h4>Governance</h4> <p>When making decisions and allocating their natural, human and financial resources, companies should consider how they will create long-term value that will benefit all stakeholders.</p> <ul style="list-style-type: none">• Purpose, values and culture• Board diversity, structure and oversight• Succession planning• Executive pay• Internal controls• Risk governance• Ethics and compliance• Shareholder rights• Governance of stakeholder engagement• Disclosure and transparency

Source: IFC ESG Guidebook

Annexure IV

Key Definitions

No.	Key Words	Key Definitions	Source
01	Insurance Ecosystem	Insurance Ecosystem as interconnected sets of services in a single integrated experience that enable insurers to embed their insurance products into seamless customer journeys.	Duck Creek Technologies
02	Sustainable Development Goals (SDGs)	The SDGs are a collection of 17 global goals set by the United Nations General Assembly in 2015 for the year 2030. They are designed to address a wide range of global challenges, including poverty, inequality, climate change, environmental degradation, peace, and justice.	United Nations
03	Environmental, Social, and Governance (ESG)	ESG (Environmental, Social and Governance) is a framework for businesses to consider the impact and dependencies on the environment and society, along with the quality of their corporate governance. It encompasses all non-financial topics that are not typically captured by traditional financial reporting.	PwC
04	Green Finance Principles	Green finance principles refer to the guidelines and standards that promote the flow of financial resources towards projects and initiatives that have positive environmental impacts. These principles aim to support sustainable development by financing projects that reduce carbon emissions, enhance energy efficiency, and promote renewable energy.	International Capital Market Association - ICMA
05	Sustainable Finance	Sustainable finance refers to the process of taking due account of environmental, social, and governance (ESG) considerations when making investment decisions in the financial sector, leading to increased longer-term investments in sustainable economic activities and projects.	European Commission

07	Clean Transportation	Clean transportation refers to modes of transport that have a lower environmental impact compared to conventional vehicles. This includes electric vehicles, public transportation, cycling, walking, and other forms of transportation that reduce greenhouse gas emissions and pollution.	U.S. Environmental Protection Agency - EPA
08	Climate-Resilient Infrastructure	Climate-resilient infrastructure refers to the design, construction, and maintenance of infrastructure systems that can withstand and adapt to the impacts of climate change. This includes roads, bridges, buildings, and other structures that are built to be durable and flexible in the face of extreme weather events and changing climate conditions.	World Bank
09	Index-Based Insurance	Index-based insurance is a type of insurance that pays out benefits based on a predetermined index (e.g., rainfall level, temperature) for loss of assets and investments, primarily in agriculture. It is designed to provide financial protection against adverse weather events and other natural disasters.	International Fund for Agricultural Development - IFAD
10	Parametric Insurance	Parametric insurance is a type of insurance that provides payouts based on the occurrence of a specific event, such as a hurricane or earthquake, rather than the actual loss incurred. The payout is triggered when predefined parameters or thresholds are met, offering a faster and more efficient claims process.	Swiss Re
11	Global Reporting Initiative (GRI)	The GRI is an international independent organization that helps businesses, governments, and other organizations understand and communicate their impacts on issues such as climate change, human rights, and corruption. The GRI Standards are the world's most widely used sustainability reporting framework.	Global Reporting Initiative

12	Task Force on Climate-related Financial Disclosures (TCFD)	<p>The TCFD is an organization established by the Financial Stability Board to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions. The TCFD recommendations provide a framework for companies to disclose climate-related risks and opportunities.</p>	Task Force on Climate-related Financial Disclosures
13	SLFRS S1 & S2	<p>IFRS S1 focuses on the general requirements for disclosing sustainability-related financial information, while IFRS S2 delves into climate-specific disclosures.</p> <p>SLFRS S1-General Requirements for Disclosure of Sustainability-related Financial Information, SLFRS S2-Climate-related Disclosures.</p>	CA Sri Lanka
14	Green Taxonomy	<p>A taxonomy in green and sustainable finance is a classification system that helps identify and classify investments as green based on their alignment with specific environmental objectives and targets. Green taxonomies can cover a wide range of objectives, such as climate mitigation, adaptation, water, circular economy, pollution and biodiversity. They also vary between countries based on their unique economic, social, and environmental challenges. A taxonomy is not an outcome in and of itself. It is a tool to help direct the flow of capital to green and sustainable projects that are aligned with environmental goals.</p>	UNESCAP

Annexure V

Related Links

1. Central Bank of Sri Lanka (CBSL). (2019). Road Map for Sustainable Finance. Colombo: Central Bank of Sri Lanka.
2. Central Bank of Sri Lanka (CBSL). (2022, May 6). Sri Lanka Green Finance Taxonomy. Colombo: Central Bank of Sri Lanka.
3. United Nations. (2015). Transforming our world: The 2030 Agenda for Sustainable Development. New York: United Nations General Assembly.
4. Global Reporting Initiative (GRI). (2021). GRI Standards. Retrieved from <https://www.globalreporting.org>.
5. Task Force on Climate-related Financial Disclosures (TCFD). (2017). Recommendations of the Task Force on Climate-related Financial Disclosures. Basel: Financial Stability Board.
6. International Financial Reporting Standards (IFRS). (2021). IFRS Sustainability Disclosure Standards (SLFRS S1 and S2). Retrieved from <https://www.ifrs.org>.
7. International Finance Corporation (IFC). (n.d.). Partnerships for Sustainable Finance Implementation. Retrieved from <https://www.ifc.org>.
8. Policy Note of the Access to Insurance Initiative (A2ii). (n.d.). Insurance for Sustainable Development Goals.

Annexure VI**Report Template****Annual Statement on Sustainable Financing Activities of Insurance Companies****As at****Name of the Insurance Company -**

Sector	Existing policies as at beginning of the year		New Insurance Policies issued during the year		Total no.of policies as at end of the year		Remarks
	No.	Value LKR Mn	No.	Value LKR Mn	No.	Value LKR Mn	
▪ Agriculture, Forestry, and Logging							
▪ Manufacturing							
▪ Electric Power Generation							
▪ Transportation and Storage							
▪ Water Supply, Sewerage, and Waste Management							
▪ Construction							
▪ Sustainable Tourism and Recreation							
▪ Other Sectors							

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Central Bank of Sri Lanka

SUSTAINABLE FINANCE ROADMAP 2.0



Scaling-up Action for the Financial Sector of Sri Lanka

Acknowledgment

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About RM 2.0...

Having completed a majority of the tasks laid out in the first Roadmap, the Central Bank of Sri Lanka along with the other stakeholders, developed the Sustainable Finance Roadmap 2.0 to cater the emerging trends in sustainable financing at the global level and to address domestic market developments and stakeholder demand in line with the Central Bankís objectives of price & financial system stability, as well as its duty on enhancing financial inclusion among Sri Lankan society. Roadmap 2.0 extends its scope to the social aspect of sustainability covering a wider spectrum of economic activities aimed at addressing the need for financial inclusion. Priority actions of the Sustainable Finance Roadmap 2.0 are to be implemented by the Central Bank of Sri Lanka together with the financial sector stakeholders over a period of five years from 2025 to 2029.

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Acronyms

BCBS	Basel Committee on Banking Supervision
CBSL	Central Bank of Sri Lanka
CSE	Colombo Stock Exchange
CSRD	Corporate Sustainability Reporting Directive
DFNS	Debt-for-nature swaps
ESG	Environmental, Social and Governance
ESMS	Environmental and Social Management System
ESRM	Environmental and Social Risk Management
EU	European Union
FCs	Finance Companies
FHA	The Finance Houses Association of Sri Lanka
FIs	Financial institutions
GCF	Green Climate Fund
GHG	Green House Gases
GRI	Global Reporting Initiative
ICASL	Institute of Chartered Accountants of Sri Lanka
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IGF	Inclusive Green Finance
IRCSL	Insurance Regulatory Commission of Sri Lanka
ISSB	International Sustainability Standards Board
IUCN	International Union for Conservation of Nature
KPIs	Key Performance Indicators
LBs	Licensed Banks
LMFCs	Licensed Microfinance Companies
MSMEs	Micro, Small and Medium Enterprises
NAP	National Adaptation Plan
NBFIs	Non-Bank Financial Institutions
NCCRS	New Comprehensive Rural Credit Scheme
NDCs	Nationally Determined Contributions
NEAP	National Environmental Action Plan

NFIS	National Financial Inclusion Strategy
NGFS	Network for Greening the Financial System
NNDIS	National Natural Disaster Insurance Scheme
SBFN	Sustainable Banking and Finance Network
SDGs	Sustainable Development Goals
SEC	Securities and Exchange Commission
SFDR	Sustainable Financial Disclosure Regulation
SLBA	Sri Lanka Banks' Association
SLCCS	Sri Lanka Carbon Credit Scheme
SLCs	Specialized Leasing Companies
SLFRS	Sri Lanka Financial Reporting Standard
UN	United Nations
UNDP	United Nations Development Programme
UNEP-FI	United Nations Environment Programme - Finance Initiative
UNFCCC	United Nations Framework Convention on Climate Change



1

Background and Purpose

Sri Lanka faces a range of environmental and social challenges that must be addressed to put the country on a sustainable growth path. From the environmental perspective, climate change represents one of the major challenges. Sri Lanka faces significant exposure to climate change. If no action is taken, the losses related to natural disasters are projected to triple by 2050 to reach 1.2% of GDP (from 0.4% today – equivalent to \$300 million).¹ Sri Lanka faces multiple environmental challenges, including pollution and deforestation. From 2010 to 2023, approximately 11.5 thousand hectares of natural forests were lost², leading to severe effects on biodiversity, livelihoods and vulnerability to climate change. Since 2000, close to 6% of Sri Lanka's tree cover has been lost. While the country has taken important steps towards addressing these vulnerabilities, especially under the National Adaptation Plan (NAP)^{3,4} and with its target to halt and then revert deforestation, a lot still needs to be done. The country has also published the National Environmental Action Plan (NEAP) 2022-2030 to address diverse environmental challenges as a pathway to sustainable development.⁵

From the social perspective, Sri Lanka has significantly suffered from the multifaceted impact of the COVID-19 pandemic, affecting the country's economic stability, health system, education, and social dynamics. Reflecting the soaring inflation and the sharp contraction of the economy, the poverty rate more than doubled between 2019 and 2022, rising from 11.3% to 25.0%.⁶ By 2023, approximately

7 million Sri Lankans - almost one-third of the population - were considered poor. Unemployment remains high in Sri Lanka, especially, with an unemployment rate that stands at approximately 22% among the youth and young graduates, compared to a global rate of 5%, in 2023.⁷ Income disparity has also widened, with urban areas recovering faster than rural regions. A recent study by the Department of Census and Statistics⁸ found that the highest 10% of the population accounted for 32.9% of total income, highlighting significant income concentration at the top. The COVID-19 pandemic and subsequent economic crisis also exacerbated several other challenges faced by the Sri Lankan society, such as increased strain on the health system and a rising gender inequality, with women, especially those in informal employment sectors, facing significant economic challenges.

At COP28, Sri Lanka indicated that it needs \$100 billion to become a net zero emitter, roughly \$4 billion per year from now up to 2050, or approximately 5% of the country's 2022 GDP. **To bridge this financing gap** – which does not include adaptation measures, other environmental actions and social initiatives – **the role of the financial sector is key**. Indeed, alternative sources of funding are limited: the contribution of domestic public finance will remain limited in the years to come in a context of fiscal constraints post-Covid-19 and restricted access to international financial markets after the country's standstill in 2022 and subsequent downgrading of its sovereign rating.

¹Sri Lanka (2021). Nationally Determined Contribution to the United Nations Framework Convention on Climate Change. 30th July 2021.

² According to Global Forest Watch.

³ Ministry of Mahaweli Development and Environment of Sri Lanka (2016). National Adaptation Plan for Climate Change Impacts in Sri Lanka. Climate Change Secretariat.

⁴ The NAP for 2016-2025. NAP tracking tool | NAP Central

⁵ An updated NAP and Provincial Adaptation Plans (PAPs) are being prepared.

⁶ Ministry of Environment (2022). National Environmental Action Plan (NEAP) 2022-2030: Pathway to sustainable development, ISBN 978-624-5817-24-5.
Source: World Bank

⁷ According to the Department of Census and Statistics of Sri Lanka

⁸Source: <https://www.statistics.gov.lk/Publication/SSR/DCSSRVol1Issue2Article3?utm>



Recognizing the significance of addressing climate-related risks to achieve its dual goals of price stability and financial system stability, the CBSL embarked on its sustainable finance initiative in 2016. The first Roadmap was launched in 2019 to address the need for incorporating environmental sustainability into the financial system to mitigate the adverse impacts of climate change by promoting policy cohesiveness across the financial sector regulators. Subsequent to the launch of the first Roadmap, initiatives such as Sri Lanka Green Finance Taxonomy and the Directions/ Guidelines for banking and NBFI sectors, which predominantly covered the green financing activities, were issued by the CBSL.

Yet, 5 years after the publication of Sri Lanka's first Roadmap for Sustainable Finance⁹, **the contribution of financial institutions (FIs) to the country's sustainability targets remains small**. There is, therefore, an urgent need to support the financial ecosystem to better align its funding with not only environmental challenges but social challenges faced by Sri Lanka and to scale up its contribution to the sustainable development objectives of the country.

The first Roadmap highlighted financial inclusion as a core pillar, but its actions were limited to developing the National Financial Inclusion Strategy (NFIS) for implementation. Over the past five years, **stakeholders have increasingly emphasized the importance of addressing the social aspects of sustainable finance**. Furthermore, the new CBSL Act enacted in 2023 acknowledges financial inclusion as a function of CBSL. Consequently, the Sustainable Finance Roadmap 2.0 (hereinafter referred to as the

Roadmap) aims to address the social dimension of sustainability in a comprehensive manner, ensuring social justice for identified vulnerable groups and MSMEs to achieve financial inclusion.

Thus, this Roadmap strengthens the existing framework by **taking stock of the trends in sustainable finance and the progress made** since the publication of the first Roadmap, in 2019. These include: i) evolutions in reporting requirements and standards, with an emphasis on those aligned with the International Sustainability Standards Board - ISSB¹⁰; ii) improved guidance on environmental risk management for the financial sector, e.g. reflected in the recent publications of the NGFS (Network for Greening the Financial System) on climate and nature-related risks; iii) a stronger emphasis on biodiversity and nature finance following the adoption of the Kunming-Montreal Global Biodiversity Framework in 2022, which recognizes the key role of the financial sector in leveraging innovative financial schemes such as green bonds.¹¹

Since 2019, the country has also experienced **changes to its policy, economic and environmental context**. For instance, new ambitious targets have been set on climate change : i) a carbon neutrality objective by 2050¹², ii) a scaling-up of renewable energy generation (to represent 70% of electricity generation by 2030¹³, iii) the commitment of no further support to capacity for coal power plants, and iv) an increase in forest cover from 29.7% to 32%.¹⁵ Sri Lanka's updated NDC also highlighted important adaptation priorities, in particular for sectors that are highly exposed to climate change. Priorities include

9 Central Bank of Sri Lanka (2019). Roadmap for Sustainable Finance in Sri Lanka. April 2019.

10 The IFRS Sustainability Disclosure Standards..

11 See Target 19 of the Framework.

12 Conditional on international support.

13 2060, in the previous communication to the United Nations Framework Convention on Climate Change - UNFCCC

14 Sri Lanka's NDC, op. cit.

15 Global Carbon Budget.

increasing the resilience of the agriculture sector through the adoption of climate-smart practices, supporting coastal protection, the preservation and enhancement of natural ecosystems and biodiversity, among others. With the publication of the NEAP¹⁶, a comprehensive set of actions covering a broad range of environmental topics beyond climate change were highlighted, including ecosystems conservation, biodiversity, waste management, air quality and sustainable resources management.

The work conducted since 2019 on sustainable finance and sustainable development in general is also useful in assessing the progress made and identifying the remaining gaps. Relevant government-related initiatives, in which sustainable financing is a key component, include: i) Climate-Smart Green Growth Strategy & Investment Plan¹⁷ (ongoing); ii) EU Green Recovery Facility (ongoing); iii) Accelerating Industries' Climate Response in Sri Lanka¹⁸; iv) Sri Lanka's SDG Investor Map¹⁹.

From the socio-economic perspective, as already noted above, Sri Lanka has been profoundly affected by the Covid-19 pandemic and its aftermath, that exacerbated social and economic challenges that were already acute in Sri Lanka. The domestic financial sector must scale its contribution to addressing these social challenges through the provision of

adapted products to low-income and vulnerable groups, including MSMEs which falls inline with the CBSL's financial system stability objective which is articulated in its intervention in upscaling financial inclusion, financial literacy and MSME financing.

This updated **Roadmap proposes a clear framework for action** to help accelerate and track progress, identifying priorities for action and determining the role of the financial sector and other stakeholders – such as policymakers – to ensure a successful implementation of these priority actions. This prioritized and phased action plan will allow to accelerate the implementation of the actions initiated by the first Roadmap and will also reflect new and updated priorities. The updated Roadmap emphasizes actions that will support Sri Lanka to position itself as "investment-ready" after its debt restructuring process, with the key guidelines and protocols in place. While acknowledging that scaling the contribution of the financial sector to the country's sustainable development requires a broad multistakeholder and multisectoral approach, this Roadmap primarily focuses on the actions that are under the mandate of the key financial sector regulators.

The rest of this document is structured as follows: Part 2 presents the thematic coverage of this Roadmap – making explicit the contribution of

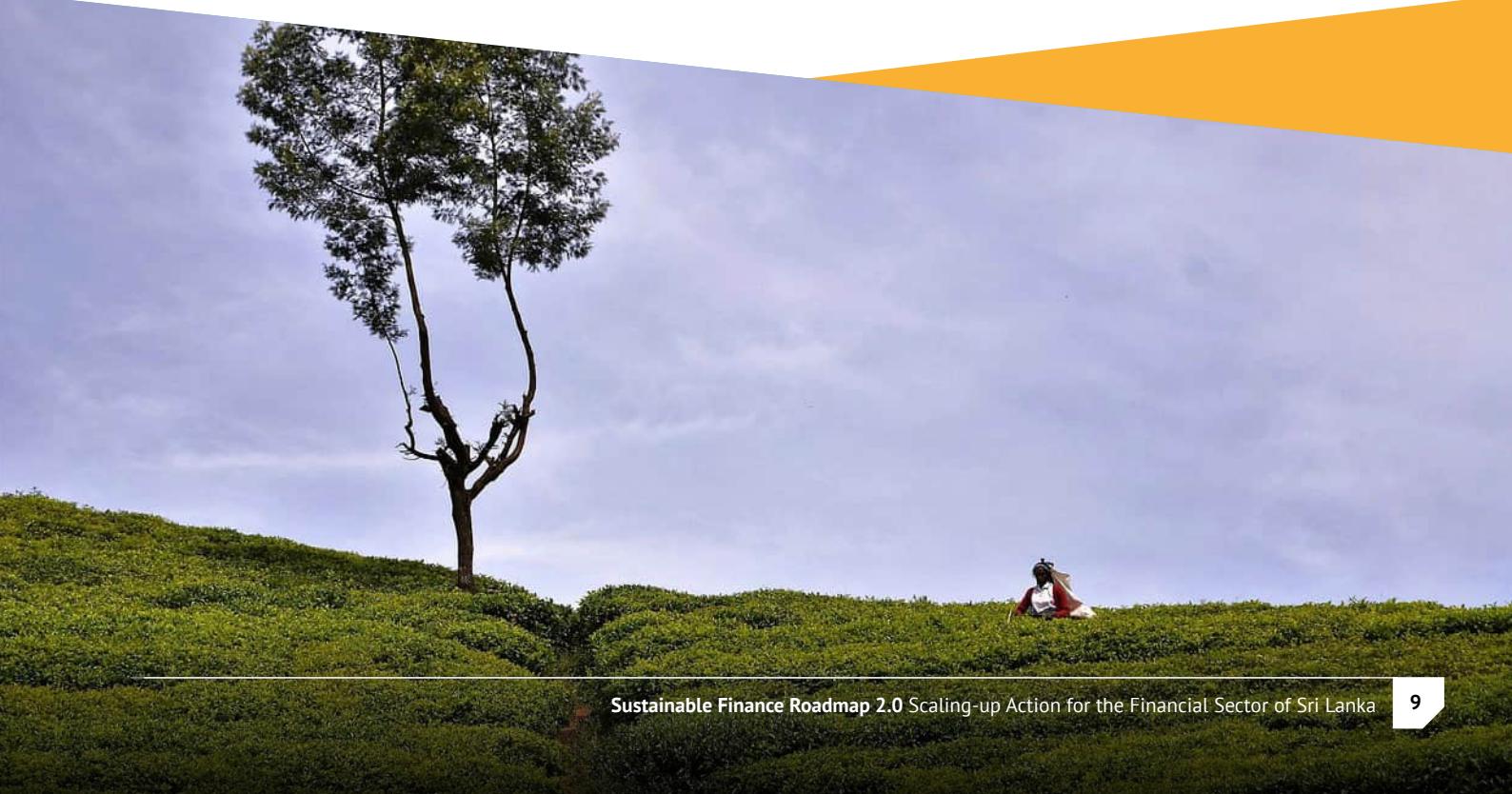
¹⁶ Op. Cit.

¹⁷ Under the GCF Readiness & Preparatory Support Project for Sri Lanka.

¹⁸ Funded by the EU under the GCCA+ initiative, implemented by UNIDO.

¹⁹ Published by the Board of Investments (BOI) Sri Lanka, Sri Lanka Sustainable Development Council (SDC), UNDP, and SDG Impact in 2023.

<https://sdginvestorplatform.undp.org/country/sri-lanka>



sustainable finance to social and environmental objectives. Part 3 investigates funding priorities, with a focus on improving uptake in sustainable financial products. Part 4 addresses the management of environmental and social risks in the financial sector, with a focus on climate risks. Reporting and disclosure is covered in Part 5, with an emphasis on

the necessary alignment of FIs on internationally recognized reporting frameworks. Part 6 presents the operational framework for action, a sequenced implementation plan integrating continuing actions from the first period of implementation (2019-2024), and the monitoring strategy.



Key Points

1. Sri Lanka is **highly vulnerable to climate change** and faces several other environmental and social challenges, such as deforestation and its effects. It has taken ambitious environmental commitments, in particular to tackle climate change mitigation and adaptation, as well as deforestation.
2. Addressing these challenges involves considerable investments, which requires a scaling up of the contribution of the commercial financial sector as well as demand-side measures. **Financing needs for climate mitigation actions only have been estimated at roughly 4 billion US dollars per year**, only a small portion of which can come from domestic public finances.
3. CBSL as the apex financial institution took initiative in developing the Roadmap 2.0 with the twin objectives of price stability and financial system stability, which require **intervention for addressing the climate related financial risks (environment) and improving financial inclusion** among various groups of the society (social).
4. The objective of this updated sustainable finance roadmap is to propose a **clear, operational and realistic framework for action** that will support FIs in scaling up their contribution to the environmental and social goals of Sri Lanka.

2

Sustainable Finance: Scope and Priorities

The purpose of this section is to provide an operational definition of sustainable finance, to determine the scope of the Roadmap and to set the thematic priorities for 2025-2029.

2.1 Defining sustainable finance

The 2019 Roadmap defined sustainable finance as the process of “supporting investment across a broad set of sectors required to build an inclusive, economically, socially, and environmentally sustainable world”. This new version of the Roadmap specifies further the concept of sustainable finance, by defining it as the process of taking environmental, social and governance (ESG) considerations into account when making investment decisions in the financial sector.²⁰ This Roadmap is also aligned with the Sustainable Banking and Finance Network (SBFN) definition of sustainable finance, which elaborates on how the integration of ESG considerations in investment decisions may be effectively operationalized, and the stakeholders involved in the process: “[Sustainable finance is] a diverse and evolving ecosystem of policies, regulations, and practices by regulators, supervisors, industry associations, and FIs to manage ESG risks and performance in financial sector activities – including climate and nature-related risks – and to encourage the mobilization of capital to assets, projects, sectors, and business activities that have environmental and social benefits.” (SBFN, 2024).²¹

Taking stock of these definitions, this Roadmap considers that:

- Both environmental and social objectives should be explicitly considered and addressed in a sustainable finance strategy. Indeed, the social dimension is one of the 3 pillars of sustainability (along with the environment and economic dimensions) and is well represented across the 17 Sustainable Development Goals (SDGs).
- FIs must help address the main environmental and social challenges faced by Sri Lanka through adapted financial products, an adequate accounting of social and environmental risks in investment

decisions and improved market transparency and confidence.

- The social and environmental dimensions of sustainable finance must be reflected in all the building blocks of a sustainable finance strategy: in its drivers (what are the challenges faced, the opportunities), in financial instruments (e.g., loans with social or environmental characteristics), risk management, as well as in reporting and disclosure.

Elaborating on the breakdown of sustainable finance activities proposed in 2019, this Roadmap further specifies the environmental and social dimensions by (see Figure 1):

- Breaking down the environmental dimension into climate change (with mitigation and adaptation being two different sub-domains) and natural assets, with biodiversity as a transversal area.
- Making explicit the contribution of the social dimension to inclusiveness, through support to MSMEs and vulnerable groups (such as youth, elderly, women) along with gender equality with social justice mainstreamed across these different areas.
- Considering the environmental and social dimensions as closely connected and supporting initiatives aiming at leveraging positive synergies between these dimensions or, at minimum, that avoid penalizing the other.

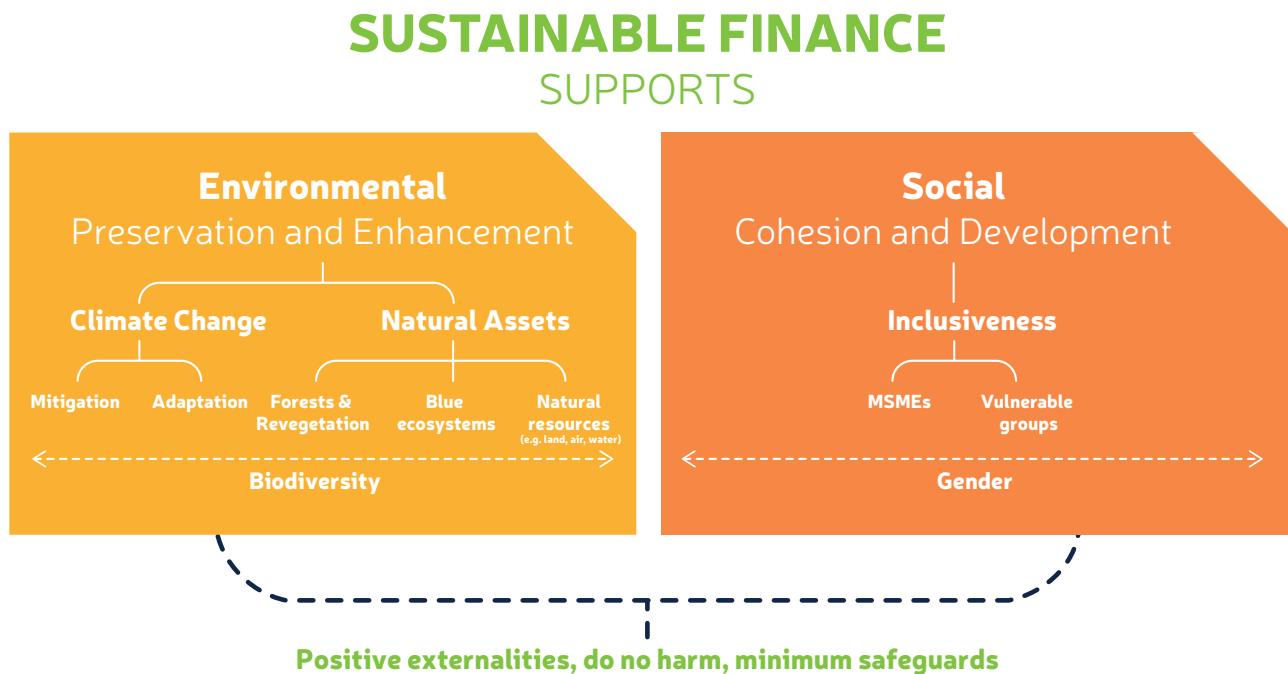
Through this structured approach, Sri Lanka aligns with best practices observed in other countries like Indonesia and follows frameworks recommended by international or multilateral organisations such as the European Commission or the IFC.²²

²⁰ https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en

²¹ SBFN (2024). SBFN Measurement Framework, 2024.

²² Refer in particular to: IFC (2023). Sustainable MSME Finance Reference Guide.

Figure 1 - Thematic Scope of the Sustainable Finance Roadmap



Source: Authors, adapted from various sources (incl. EU and IFC, 2023)

By channelling resources to any of these areas, the financial sector will directly contribute to address some of the most pressing social and environmental challenges faced by Sri Lanka. These new or improved investment areas also provide further diversification

opportunities to investors, national or international, eager to support projects driven by social or environmental impact.

2.2 Priority areas

Considering the environmental and social challenges faced by Sri Lanka, the initiatives taken and progress made so far, as well as the international commitments of the country (SDGs, Nationally Determined Contribution to the UNFCCC²³), the following priority areas have been identified for this Roadmap (2025-2029)²⁴:

- **Climate change mitigation.** Sri Lanka has defined an ambitious target of increasing the share of renewable energies²⁵ in the energy mix to 70% by 2030²⁶, to support its objective of 14.5% reduction in GHG emissions by 2030 and net zero by 2050.²⁷ Actions aiming at mitigating climate change also contribute to inclusiveness and social objectives, particularly those that support access to sustainable energy and sustainable transport. For example, decentralized thermal energy generation from sustainable biomass, such biochar or pellets, may offer access to cleaner energy for cooking, lighting or air-conditioning to populations and MSMEs located in remote areas. Support to cleaner transportation modes, such as electric vehicles, can foster mobility while contributing to the country's climate goals, air quality, and other environmental dimensions.
- **Climate change adaptation.** As a country highly exposed and vulnerable to the effects of climate change, the National Adaptation Plan of Sri Lanka²⁸ has identified a series of actions to raise the resilience of communities and ecosystems to climate change, reducing their vulnerability and capturing any opportunities arising from this transition. Sri Lanka's updated NDC has also identified a broad set of adaptation actions covering a wide range of sectors and themes, including agriculture, health, urban planning and tourism, among others. While the updated NDC did not provide a full prioritization of these actions, it did flag investments in new technologies, climate-smart practices, and efficient water management as key to support agriculture productivity, food security and income, and greater resource management efficiency (water, land, food processing and preservation). The updated NDC also highlighted that leveraging traditional knowledge in crop types, cropping systems, water management, food preparation and preservation will be important to build resilience in key sectors such as agriculture and food security, water and forestry. The contribution of the financial sector to these objectives is critical considering the magnitude of the financing needs which, as emphasized in the updated NDC, cannot be born solely through public investment or through financing from climate funds, bilateral and multilateral agencies.
- **Forests and other critical natural assets.** The reversal of deforestation targeted by 2030 (increase of forest cover from 29.7% to 32%) requires the funding of ambitious long-term reforestation and forest conservation projects. Facilitated access to alternative funding sources, such as carbon and biodiversity markets, would support the financing of these long-term projects. The Sri Lanka Carbon Credit Scheme (SLCCS)²⁹ could be leveraged for that purpose. The enhancement of forests and other natural assets has many benefits, including on climate change mitigation (through increased carbon storage), biodiversity (habitat protection), livelihoods (preservation of agrobiodiversity and its products) and the creation of new sustainable economic opportunities. Regarding the latter, the preservation and promotion of Sri Lanka's blue ecosystems, one of the country's major natural assets, could be better leveraged for sustainable growth, for example through improved marine and coastal management as well as sustainable tourism.
- **Inclusiveness.** The transitioning of Sri Lanka to a middle-income economy requires addressing the socio-economic challenges faced by the most vulnerable segments of its population and economy. In that respect, providing access to the

²³ Sri Lanka (2021). Nationally Determined Contribution to the United Nations Framework Convention on Climate Change. 30th July 2021.

²⁴ These priority areas emphasize sectors and areas where the country has binding commitments, e.g. through the updated Nationally Determined Contributions (NDCs), the National Adaptation Plan (NAP), and the Technology Need Assessment (TNA) and Technology Action Plan (TAP) to address climate change. This does not mean that other areas will not be addressed or that areas not explicitly mentioned here will not be given priority in future versions of the Roadmap and implementation periods.

²⁵ Renewable energy sources may include solar, wind, tidal, hydro, geothermal and hydrogen.

²⁶ Nationally Determined Contributions of Sri Lanka, op. cit.

²⁷ Both targets are conditional on international support.

²⁸ op. cit.

²⁹ <https://www.climatefund.lk/slccs.html>

formal financial sector to MSMEs, low-income households, youth and women is necessary to support equitable economic growth. As emphasized in the National Financial Inclusion Strategy (NFIS)³⁰, this requires working on an enabling environment and infrastructure, for example through the development of secure and efficient digital payments, raising financial consumer protection standards, as well as increasing financial literacy among target groups. The second phase of the NFIS³¹ will address new policy initiatives aimed at promoting Inclusive Green Finance (IGF), with a particular emphasis on MSMEs.

Beyond financial inclusion, different policies and frameworks adopted by Sri Lanka emphasize the need to mainstream social justice and inclusion in environmental strategies and actions. For example, the updated NDC highlights the importance of mainstreaming gender and social safeguards into adaptation priorities. It also states that adaptation strategies should enable contribution by women as well as provide equal access to benefits, which requires investing in gender-responsive training, promote more entrepreneurial skills among women and facilitate their access to technology and finance.

³⁰ Central Bank of Sri Lanka (2021), National Financial Inclusion Strategy for Sri Lanka (2021-2024).

³¹ The first phase covered 2020-2024.

Key Points

1. The updated Sustainable Finance Roadmap of Sri Lanka proposes to **explicitly address the environmental and social dimensions** of sustainable finance.
2. The environmental dimension is decomposed into 2 sub-dimensions: **climate change and natural assets**.
3. The social dimension explicitly aims at supporting **inclusiveness**, through initiatives targeting MSMEs, gender inequality and vulnerable groups of population.
4. The Roadmap considers as **priorities for 2025-2029** the following areas:
 - Climate change mitigation, through increased renewable energy generation and access to clean energy.
 - Climate change adaptation, through improved resilience and climate-proofing of infrastructure.
 - Forests and other critical natural assets.

3



Funding
Sustainable
Development

The purpose of this section is to discuss how the supply and demand of sustainable finance products could be incentivized to support a more efficient contribution of the financial sector to the social and environmental priorities of Sri Lanka.

3.1 Market instruments

While Sri Lanka has made progress in developing policy frameworks for sustainable finance, through the 2019 Roadmap, the development of the Green Finance Taxonomy, the Green and Social Bond Framework for the corporate sector, among others, renewed efforts are needed to translate these policies into tangible outcomes. Discussions between CBSL and industry stakeholders, as well as various studies, suggest that the comparatively low adoption of sustainable finance in Sri Lanka can be attributed to several factors. These include a lack of common understanding of sustainable finance, limited awareness among financial institutions (FIs) and end-clients regarding sustainable funding opportunities, and inadequate incentives.

This section addresses market awareness by presenting the major sustainable finance instruments – within the scope of action of the financial regulators – to stimulate their adoption by local FIs, building on the experience of frontrunners in Sri Lanka that have already issued or subscribed some of these instruments (e.g. green loans) and on successful international experiences. The starting point is to agree on a simple and operational definition of sustainable financing: **any type of financing that includes agreed-upon social or environmental eligibility or use of funds criteria.**

Reflecting the interconnection between social and environmental objectives and the necessity to mainstream social aspects into environmental policies and actions, sustainable finance products should seek to leverage synergies between social and environmental outcomes, for example by restricting eligibility or use of funds to projects combining these two dimensions. This could be achieved by combining eligibility conditions (e.g., on income and/or location) with use of funds criteria to ensure that funding supports both environmental and social benefits (for example, the

purchase of solar panels for households with income below a given threshold). At minimum, sustainable finance products should contain safeguards preventing harmful impacts on the other dimensions (e.g. social safeguards in environmental projects and vice versa). These safeguards, that apply to all sustainable finance products, should be aligned with recognized international standards, such as the IFC Performance Standards, or the UN Guiding Principles on Business and Human Rights, among others. A comprehensive sustainable finance taxonomy, covering inclusiveness and social dimensions, is an efficient tool to develop the supply and uptake of sustainable finance products and ensure that funding is effectively channelled to projects with social and environmental benefits. Further details are provided on this in Section 5.2.

The sustainable finance instruments with the highest potential for Sri Lanka and within the scope and mandate of CBSL are discussed below.

i) Sustainable loans, deposits and leasing

Sustainable loans are a form of financing that enables borrowers to use the proceeds to exclusively fund projects that make a substantial contribution to environmental and social objectives. These sustainable loans may be directly funded by the proceeds of sustainable deposits, which consist of financial products that enable individuals and organizations to direct their funds to banks and NBFIs (Non-bank financial institutions) to finance sustainable projects. For the purposes of this Roadmap, NBFIs comprise entities regulated by CBSL, finance companies (FCs), licensed microfinance companies (LMFCs) as well as one specialized leasing company (SLC), and also insurance companies, regulated by the Insurance Regulatory Commission of Sri Lanka (IRCSL). Sustainable leasing schemes fund the purchasing of physical assets that generate

sustainability benefits, such as electric vehicles, solar panels, and energy-efficient equipment.

Sustainable loans - generally called green loans in Sri Lanka - are one the most common sustainable finance instrument and are already offered by most commercial banks in Sri Lanka. So far, these loans have mostly funded energy efficiency improvements as well as off- or on-grid power generation from renewable sources. This said, some FIs, have started to expand their green loan schemes to other sustainable activities, such as the funding of the local manufacturing of organic fertilizer, pesticides and herbicides. Other thematic priorities for sustainable lending and leasing in Sri Lanka include the funding of climate-smart infrastructure (both retrofitting existing infrastructure and new investments), water management and recycling as well as blue ecosystems, for example through coastal reforestation, revegetation, agroforestry, and sustainable aquaculture.

Scaling-up loans or leasing schemes with a social lens, or with combined social and environmental objectives, contributes to improving incomes and access to basic services for vulnerable segments of the population. As noted by the NFIS, scaling-up MSME lending with a specific focus on green and sustainable finance is a necessity to reach social and environmental goals. But these funding instruments remain a challenge for the issuers as they typically rely on subsidized interest rates models. To lower the cost of funding, these subsidized funding sources may be accompanied by risk mitigation mechanisms, alternative credit scoring and eligibility criteria for informal and low-income workers (for example, on income thresholds and tenure) and

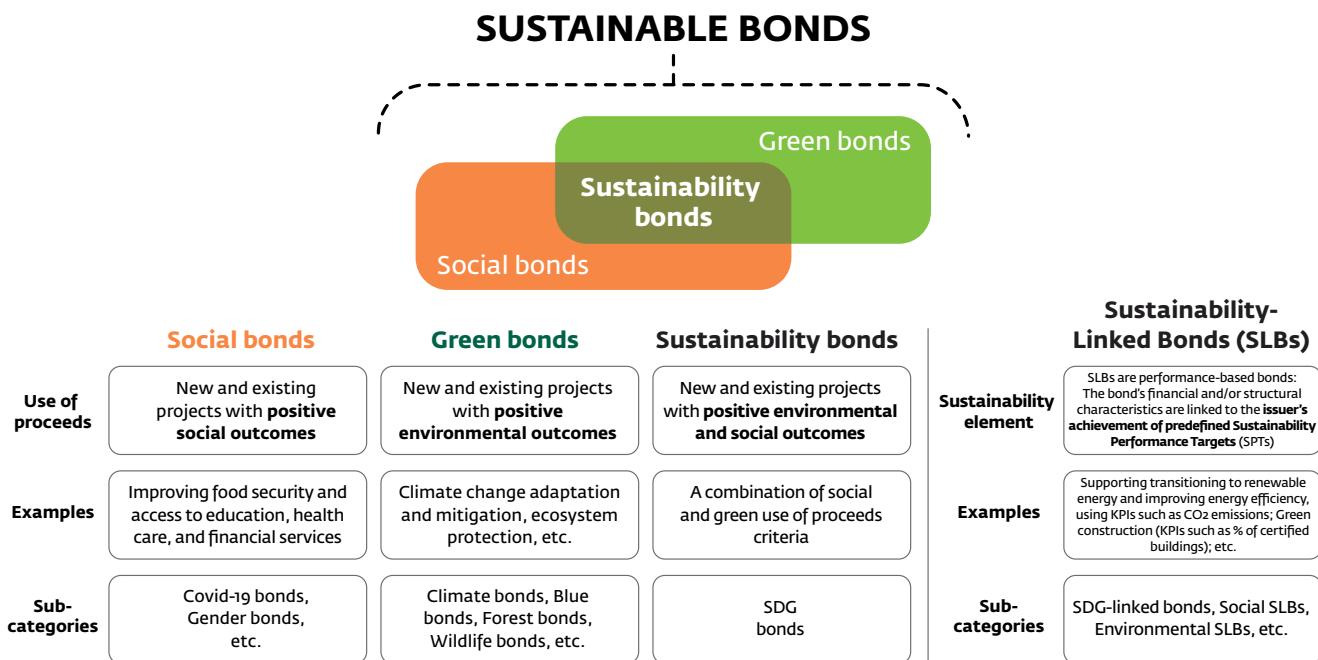
product innovation (incremental housing loans, for example). Sectors with a high prevalence of MSMEs may be targeted by these actions, such as farming, aquaculture, fishing or tourism, with an emphasis on investments that maximize positive environmental and social benefits (for example, the funding of solar panels for households or small businesses, purchase of electric vehicles for MSMEs, etc.).

To encourage FIs to broaden the scope of green loans and leasing schemes to other sustainable activities and to propose conditions (maximum amounts, tenure) aligned with the characteristics of sustainable investments, further clarity should be provided on the financial risks and opportunities associated with environmental transition. This could be supported by the issuance of directions/ guidelines on sustainable loans, leasing and deposits, and accompanied by awareness-raising and capacity-building actions among target groups to improve the uptake of these products.

ii) Labelled bonds

Green bonds, social bonds, and sustainable bonds constitute the three main families of labelled bonds, also often referred to as sustainable bonds. Green and social bonds aim to raise capital to fund projects with environmental or social benefits, respectively, while sustainable bonds finance projects with both positive social and environmental outcomes. Other labelled bonds can generally be grouped under one of these three families. These include, SDG bonds, a type of sustainability bond that aims at channelling funds to address specific Sustainable Development Goals (SDGs), and Climate bonds, a special type of Green bond, to name a few (see Figure 2).

Figure 2 - Defining labelled or Sustainable bonds



Source: Authors

Sri Lanka possesses a regulatory framework for corporate green bonds since 2023³² and the uptake in these funding instruments is starting to materialize, despite a complicated macroeconomic context. Several of the country's major banks have established their own green or sustainable bond framework, indicating possible issuances in the coming months or years. A bank has issued in July 2024 the country's first green bond (aligned with 2023's green bond framework) for up to LKR 2.5 billion (Sri Lankan rupee denominated bond, unsecured) to finance or refinance green projects in sectors such as waste management, renewable energies or clean transportation, among others. In March 2025, SEC approved the Social Bond Framework for Sri Lanka.

To better position itself in a dynamic market (forecasted to rise by 10% in 2024 - to reach 260 billion USD in issuances in Asia-Pacific³³), Sri Lanka may develop a more comprehensive **sustainable corporate bond framework** to support issuances for a wider range of environmental and social objectives. This sustainable corporate bond framework must be connected with the updated Green Finance Taxonomy to identify eligible activities for funding.

iii) Debt-for-nature swaps

Debt-for-nature swaps (DFNS) are agreements whereby creditors accept to provide debt relief in exchange for environmental investments. DFNS - which tend to focus on the low and middle-income countries that are the most vulnerable to environmental threats - free up fiscal resources that countries can allocate to environmental projects, without weighing on public debt. This non-traditional source of financing may regain interest in the current global environment, characterized by high geopolitical pressures and economic challenges (post Covid-19 financial impact, high interest rates, inflation and food prices), that are increasing the pressure on sovereigns. DFNS may be further explored as a source of financing for environmental conservation projects in Sri Lanka, in a context of costly access to financial markets and limited fiscal resources.

iv) De-risking instruments

Environmental projects typically have long-term horizons, higher structuring and monitoring complexity, and are often perceived as riskier ventures. This is especially the case for much needed projects involving land-use or primary activities, such as

³² Securities and Exchange Commission of Sri Lanka (2023). Green Bond Framework. October 2023. Social Bond Framework, March 2025.

³³ According to S&P Global.



fisheries, agriculture, reforestation and environmental conservation in general or new technologies (e.g. carbon capture, hydrogen etc.). A more widespread adoption of de-risking mechanisms, such as credit guarantees or blended finance structures, would facilitate private investment in projects that otherwise would not be considered as commercially or financially viable.

For example, FIs could explore blended finance mechanisms, that combine relatively small amounts of risk-tolerant capital ("concessional capital") with capital seeking market-rate returns to rebalance the risk-reward profile of environmentally and socially focused investments which otherwise would not be attractive for private investors. Blended finance solutions can be structured as debt, equity, risk-sharing, or guarantee products with different characteristics in terms of rates or tenor, for example. The context in Sri Lanka could be conducive for the development of blended finance with the existing regulatory framework on sustainable finance.

v) Sustainable insurance

Sustainable insurance includes insurance against environmental-related risks as well as schemes specifically targeting vulnerable segments of the population and economy which tend to be excluded from the traditional insurance market, such as MSMEs. The most common type of sustainable insurance addresses climate-related risks, such as climate-induced disasters (e.g. flooding) or other events (high temperatures, low precipitations, etc.). These products support the economic viability of projects in fields such as agriculture, fisheries, tourism as well as for other activities or assets (e.g. infrastructure) that are highly exposed to climate and weather-related risks, by reducing the commercial and financial risk of these ventures.

The 2019 Roadmap noted the importance to encourage industry players to create innovative climate and disaster insurance products, such as home insurance to protect farmers and homeowners against the loss of crops and damage to property due to natural disasters. Considering the vulnerabilities as well as the opportunities of the Sri Lankan economy, the development of climate insurance products should be a priority in sectors such as agriculture and fisheries. Beyond climate-related risks, the 2019 Roadmap also highlighted the potential for pollution liability insurance to reduce the risk profile of environmentally sensitive investments.

But the adoption of sustainable insurance products, even of the most basic climate-related insurance schemes such as crop insurance, remains very low. This is largely due to a lack of awareness on these products, a lack of transparency in loss assessments, an underestimation of indemnity payments, and the general indemnity-based nature of the insurance schemes. Improved risk assessments and underlying data should support the offer and pricing of commercial climate-related insurance products, and contribute to improve existing public schemes, such as the National Natural Disaster Insurance Scheme (NNDIS). In that perspective, **insurers and regulators should be exposed to training on climate change data and risk modelling**, leveraging the expertise residing among development partners, industry associations, networks as well as recent work in this field.³⁴

The improvement of the regulatory framework on climate insurance and disaster risks is also needed to support the development and uptake of market-oriented risk financing and insurance. The Insurance Regulatory Commission of Sri Lanka, together with industry stakeholders, should **assess the potential for**

³⁴ For example: Stimson (2022). CORVI Risk Assessment: Western Province, Sri Lanka

adoption of innovative climate insurance products, such as index-based insurance³⁵, which may improve coverage against major risks and lower entry costs for vulnerable population groups. This work could lead to the development of a fully-fledged **disaster risk finance strategy** based on a risk layering approach and the formulation of **regulations and policies for catastrophe pools, index-based insurance and microinsurance**, focusing on the most exposed sectors

such as fisheries and tourism. These regulations should guide FIs on how insurance schemes could be made more accessible to the poorest households as well as to MSMEs, which are also the most exposed to the effects of climate change but are unable to afford the premiums.

Raising awareness on the benefits of insurance among the most vulnerable groups is a necessity to improve the adoption of insurance products.

3.2 Incentivizing sustainable finance

To boost the adoption of sustainable finance products, adapted incentives are needed both for FIs and borrowers or end-clients to increase the attractiveness of these products and compensate for their high perceived risk or structuring and reporting.

Given the current monetary, fiscal and sovereign context in Sri Lanka, the room for introducing new economic incentives or expanding existing mechanisms is limited in the medium-term. Rather, the focus could be placed on greening and improving the inclusiveness of existing incentive schemes - such as introducing or reinforcing green and social eligibility criteria in the New Comprehensive Rural Credit Scheme (NCCRS), on regulatory incentives and on alternative incentive schemes (e.g. reward and recognition).

Regarding **regulatory incentives**, the progressive inclusion of sustainability metrics or requirements in the macroprudential regulation could be envisaged to incentivize the expansion of sustainable portfolios among commercial banks. A flexible approach should be adopted, in particular in terms of FI size or sectoral focus, as some corporate banking business models may restrict lending to specific sectors, e.g. potentially excluding MSMEs or other sustainable investments. A first step could consist **conducting of a comprehensive study on regulatory incentives**, reviewing experiences and best practices in the region, **followed by an industry consultation**.

Reward and recognition schemes also provide incentives for market actors to raise their targets and achievements. Different types of schemes could be envisaged for FIs: i) Industry awards, for example, recognize companies that excel in sustainable finance practices and motivate FIs to adopt more sustainable practices; ii) Sustainability disclosure awards, recognizing firms that excel in transparency and reporting on sustainability metrics, contribute to raise the overall quality of disclosures. This requires prior harmonized guidelines or regulatory framework on sustainability reporting (see Section 5.1 for further details); iii) Sustainability-linked compensation packages for executives that reflect the achievement of sustainability targets which foster the integration of sustainable finance at leadership level, trickling-down to the rest of the organization. This is one of the disclosure requirements of sustainability standards such as IFRS/ISSB (S1 and S2) or GRI; iv) Sector-wide competitions to develop innovative sustainable finance solutions, spur financial innovation and commitment to sustainability among market participants. Sustainability ratings and performance evaluations must be verified by accredited independent third parties to ensure the objectivity and credibility of the scheme. As a preliminary step, best practices in the region could be assessed.

³⁵ Also known as parametric insurance.



Key Points

1. The market for green loans in Sri Lanka is growing and maturing, with most commercial banks proposing this type of instrument. However, FIs must be encouraged to scale up their offer **by expanding the scope of existing green loans to other sustainable activities** and to propose conditions aligned with the characteristics of sustainable investments and adapted to MSMEs. This can be achieved through a strengthening of the regulatory framework on sustainable lending.
2. **Raising awareness on existing schemes and improving the capacity of FIs to develop innovative financial products and mechanisms** adapted to the local market, including new insurance products and other de-risking mechanisms, is necessary.
3. **Developing and introducing a coherent incentives package** that do not require fiscal or monetary support, combining regulatory, economic and reward and recognition schemes, is critical to improve the uptake of sustainable finance products, at present.
4. **Strengthening the policy and regulatory framework on sustainable insurance**, especially on climate insurance, to support the adoption on innovative instruments such as index-based insurance.

4

Managing Environmental and Social Risks

The purpose of this section is to discuss how FIs could improve the identification, assessment and management of social and environmental risks, especially those related to climate change.

4.1 The importance of effectively managing environmental and social risks

Managing environmental and social (E&S) risks is critical for FIs to ensure sustainable operations, maintain their reputation, and align with regulatory requirements.

This is not just a regulatory obligation or a desirable ethical practice but a strategic necessity. By integrating E&S practices in their business and corporate procedures, FIs can not only mitigate risks but also capitalize on opportunities in sustainable finance and support their financial performance. Solid E&S practices help align with the growing market for ESG-compliant financial products,

reduce credit default risks (e.g. from environmental damages or social disputes), preserve asset value (e.g. from climate-related events that affect the value of physical assets), and reduce operational risks associated with reputation or legal liabilities arising from the involvement of FIs in the financing of controversial activities.

Before supporting FIs introducing adapted environmental and social risk management (ESRM) frameworks and procedures, the knowledge gap on climate and E&S risks in the financial sector, including at regulatory level, must be addressed.

4.2 Strengthening knowledge on environmental and social risks

Sri Lanka is exposed to a wide range of environmental and social risks. Being a tropical island in the Indian Ocean, Sri Lanka is one of the countries with the highest exposure to climate change. While climate change is already severely affecting the country, its adaptative capacity and resilience is lagging. The Sri Lankan economy - and its FIs - are therefore exposed to a range of other environmental risks that must also be identified, characterized and assessed. These reflect the dependence of the economy on critical natural assets, such as biodiversity, the availability and quality of groundwater resources, soils and the wide range of services provided to the economy by healthy ecosystems (water filtration, coastal protection, prevention of soil erosion etc.). Social risks, which are often even more difficult to characterize, assess and quantify, are highly relevant as well. They refer to the impact on the economy of high poverty levels and high inequality rates.

Much needed investments in sustainable projects, for example in critical resilience-building activities in sectors

such as coastal protection, climate-smart agricultural practices, biodiversity and ecosystem conservation, are constrained by a poor understanding of the exposure to different classes of risks (physical and transition risks³⁶) and a lack of integration of these risks in project evaluation and in the overall processes of FIs.

Despite their importance for the financial sector in Sri Lanka, there is limited insights and detailed analysis of environmental risks, especially of physical climate-related risks. Several regional climate risk assessments have been conducted recently in Sri Lanka by different institutions³⁷, but more coherent methodological frameworks (data and models) are needed to provide relevant nation-wide insights on climate risks. In particular, **local expertise on climate risks that is specific to Sri Lanka must be developed** to strengthen risk assessments and allow adequate responses by FIs and supervisors. As noted earlier, improving access to data on natural disasters and strengthening the capacity of FIs on climate risk models,

³⁶ Physical risks consist in the exposure of the balance sheets of FIs to assets and activities that may be heavily disrupted by environmental or social conditions, such as climate change, in critical sectors such as tourism, infrastructure, housing or agriculture. Transition risks arise from the need to progressively shift towards a more sustainable economy, which implies transitioning from activities with high negative impacts (e.g. fossil fuel energy generation) to those with less negative or more positive contributions (e.g. renewable energies). This process entails specific physical, financial, legal as well as reputational risks for FIs that must be managed.

³⁷ For example: Capacity Development of Local Governments and UNDP (2023). Climate Vulnerability Risk Assessment in Uva Province, op. cit.

climate scenario analysis and catastrophe assessments is a necessity.

Internal capacity among supervisors on environmental risks – and climate risks in particular - is also limited and must be strengthened, with a focus on developing modelling capacity and stress-tests that account for climate factors. A major output would be the development of a climate risk analysis covering the entire financial sector. This would constitute a foundational element for a system-wide supervisory response on E&S risks and

would support outreach and further capacity building among FIs, along with the necessary technical assistance.

With respect to other environmental risks, regulators, FIs, and key government partners may consider connecting with key international initiatives, such as ENCORE³⁸ (led by UNEP-FI) or under the Network for Greening the Financial System (NGFS)³⁹, to **gain some exposure to nature-related risk assessment frameworks and their implications for financial regulators**.

4.3 Supporting the integration of environmental and social risks in FI processes

To support a better alignment of the financial system in Sri Lanka with the country's sustainability priorities, FIs must be supported to develop and implement procedures that explicitly account for environmental and social risks in their business and operational processes, starting with the development of organization-level ESRM frameworks outlining the overall approach of FI's to E&S considerations and detailing how E&S criteria will be embedded into:

- Credit-granting and investment processes, for example through adapted credit scoring models;
- Due diligence and monitoring processes, through the use of social and environmental safeguards or do-no-harm criteria aligned with international best practices, such as the IFC Performance Standards, the Equator principles or the UN Principles on Responsible Banking;
- Corporate governance and internal processes, for example through the creation of dedicated E&S teams, capacity-building programs;

- Financial (e.g. prudential ratios) and non-financial reporting and disclosure practices, supporting the alignment with industry standards (e.g. IFRS/ISSB, see Section 5.1). These processes may be supported by the use of specific resources, such as ESG rating systems or external client databases to screen client risks, or technological tools such as remote-sensing or geospatial analysis to assess deforestation or other environmental risks.

Regulators may support this process by **strengthening the policy framework on E&S risk management in the financial sector**. This includes preparing general policy guidelines outlining the approach to E&S management in the financial sector, as well as sector-specific guidelines for high-risk activities, such as tourism, agriculture and fisheries or energy. Best practices and guidelines, such as those recently published by the Basel Committee on Banking Supervision (BCBS), could be leveraged for that purpose.

³⁸ <https://encorenature.org/en>

³⁹ NGFS (2024). Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors. July 2024.

Sri Lankan FIs should also be encouraged to leverage (and be trained on) the several international frameworks, policies and operational guidelines that exist on this topic to develop their own ESMSs or to benchmark and improve their existing systems. These include (among others):

- IFC's FIRST (Financial Institutions: Resources, Solutions and Tools) for Sustainability knowledge portal, that follows the IFC Performance Standards.
- IUCN's Environmental and social management system, which is more geared towards project evaluation.
- The Global Environmental Facility's policy on environmental and social safeguards ;
- The Green Climate Fund's Environmental and social management system.

Since the publication of the Sustainable Banking Initiative in 2015, signed by 18 Sri Lankan banks, which included as its first principle environmental and social risk management, significant progress has been made by the financial sector in Sri Lanka on E&S integration. Most signatory banks – and beyond (e.g. insurance companies) – have introduced ESMS systems or sustainability frameworks. 10 years after the adoption of the sustainable banking principles by all the major FIs of Sri Lanka, it is advisable to conduct a **sector-wide study on the degree**

of implementation of E&S risk management practices

and to identify the main challenges encountered. Based on this assessment, a **relevant capacity-building plan can be developed** by the regulators to address

these challenges and support the sector to align with international best practices. NBFIs, such as insurers and licensed microfinance institutions, should receive special attention in this assessment given the nature of their loan portfolio - with overrepresentation of MSMEs and vulnerable segments of the population - and their comparatively high-risk exposure to social and financial risks.

E&S risk management considerations could be

strengthened in the regulatory framework, by

upgrading the existing directions and regulations issued to licensed banks, finance companies and licensed microfinance companies issued under the Banking Act, Finance Business Act and the Microfinance Act, respectively. The introduction of E&S requirements in financial regulations requires a progressive approach, starting with basic disclosure requirements and progressively working towards integrating environmental and social risks in macro-prudential indicators and ratings. A pilot-testing phase may be conducted with selected FIs to identify relevant metrics and testing strategies.

Key Points

1. **Sri Lanka is among the countries most highly exposed to the impacts of climate change**, such as extreme weather events, as well as to other nature-related risks.
2. **Capacity of supervisors and FIs needs to be strengthened on E&S risks**, and particularly on climate risk analysis and modelling to support the assessment of the exposure of the financial sector to climate risks.
3. It is necessary to **take stock of the progress made during the past 10 years in developing and implementing ESMS frameworks** in the financial sector, to identify the remaining needs and challenges that must be addressed, e.g. through targeted capacity-building actions.
4. **A strengthening of policy and regulatory frameworks on E&S risks** is required to support their integration in the business and corporate processes of FIs.
5. **The assessment and management of E&S risks should be aligned with international ESRM standards** like the IFC Performance Standards or the Equator Principles, and good practice for 'do no significant harm' and minimum social safeguards criteria.

5

Reporting and Disclosure

The purpose of this section is to address the actions supporting quality disclosures on environmental and social risks and impacts, improving market transparency and the alignment of the financial sector with international best practices.

Enhancing non-financial disclosure at both corporate and portfolio-level is critical to improve transparency and confidence in sustainable finance, to minimize the risks associated with social or greenwashing, and to increase the uptake of sustainable finance by investors, lenders and end-clients. Investors and FIs need adequate information on pricing,

risks (e.g. climate) and impacts to efficiently align their capital with sustainability objectives.

Disclosure requirements typically cover the management of E&S risks and opportunities, as well as the social and environmental impacts of the organization through its functioning (footprint) and business activities (e.g. of its portfolio).

5.1 Reporting and disclosure standards aligned with international best practices

Comprehensive and systematic non-financial reporting and disclosure is not yet mandatory for all companies in Sri Lanka. In the past couple of years, regulators and industry bodies have made progress on developing guidance for the sector. For example:

- CBSL encourages licensed banks and finance companies to disclose environment and social impact generated from business activities using internationally recognized frameworks, such as the Global Reporting Initiative (GRI) and the recommendations of the Taskforce on Climate-related Financial Disclosures.⁴⁵
- The Colombo Stock Exchange (CSE) amended its listing rules to require all listed companies to have an ESG policy on their website as of 2023.⁴⁶
- CSE has also published sustainability reporting guidelines, to support listed companies communicate their sustainable performance in a clear, systematic and coherent way.⁴⁷
- The Institute of Chartered Accountants of Sri Lanka (ICASL) has issued localized versions of the latest IFRS Sustainability Disclosure Standards, designated as SLFRS S1⁴⁸ and SLFRS S2⁴⁹, which will progressively

enter into force from January 1, 2025.

Reflecting this evolving and complex landscape (e.g. many reporting standards available, new ones emerging regularly, lack of interconnection between standards), the uptake of ESG reporting and disclosures in the Sri Lankan financial sector (and beyond) remains limited. In a recent survey conducted by the GRI, only 92 companies prepared and disclosed sustainability reports in 2023.⁵⁰ To provide clarity on reporting and disclosure in view of the progressive rolling-out of SLFRS S1 and S2, which will become mandatory for all major listed licensed commercial banks, **clear supervisory guidance is needed on how FIs can effectively implement these standards in the financial sector**. This will support the necessary alignment of reporting and disclosure standards for listed licensed banks, and NBFIs with SLFRS S1 and S2 and, beyond, contribute to a widespread adoption of sustainability reporting best practices among FIs in Sri Lanka. Likewise, building on the capacity-building program on SLFRS S1 and S2 currently being developed by ICASL in collaboration with CBSL, training should be extended to FIs to support the effective implementation of these standards, including on background data and information required to support the reporting process.

⁴⁵ Banking Act Direction No.5 of 2022, 8.2

⁴⁶ Colombo Stock Exchange (2023). Listing Rules, Section 9.

⁴⁷ Colombo Stock Exchange (2023). CSE Sustainability Reporting Guide.

⁴⁸ Institute of Chartered Accountants of Sri Lanka (2024). Sri Lanka Sustainability Disclosure Standard S1 (General requirements for disclosure of sustainability-related financial information).

⁴⁹ Institute of Chartered Accountants of Sri Lanka (2024). Sri Lanka Sustainability Disclosure Standard S2 (Climate-related disclosures).

⁵⁰ As of Sep. 30, 2023. GRI (2023). Sustainability Reporting in Sri Lanka 2023: Connecting the dots.

A working group involving supervisors, relevant line ministries and associations (e.g. chartered accountants) may be set-up to monitor developments on sustainability disclosures and provide updated guidance and capacity-building to stakeholders in the financial sector. Initiatives that may be reviewed and monitored by this working group include - among others

- IFRS Sustainability Disclosure Standards (S1 and S2), GRI, EU's Corporate Sustainability Reporting Directive (CSRD) and its two connected regulations: The Sustainable Finance Taxonomy Regulation and the Sustainable Financial Disclosure Regulation (SFDR). Other initiatives such as the IFC's transparency toolkit may also provide inputs for capacity-building actions.

5.2 Expanding the scope of the Green Finance Taxonomy

A sustainable finance taxonomy is an efficient tool to develop the supply and uptake of sustainable finance products. By identifying the activities that can be considered as sustainable by the regulator, clarity is provided to the market on what is and what is not sustainable, reducing the risk of social or green washing and improving overall confidence in sustainable finance. The taxonomy also supports the development of sustainable finance products: a climate loan, for example, can simply be defined as a loan that funds activities falling under one of the climate mitigation or adaptation categories of the taxonomy and respecting potential technical criteria and minimum safeguards (e.g. social).

CBSL has published a Green Finance Taxonomy⁵¹ in 2022, which constitutes a milestone in the development of sustainable finance in the country. This taxonomy covers a wide range of environmental activities and sectors (e.g. forestry, agriculture, energy, transport, tourism,

etc.). There is now a need to conduct an **industry-wide study on the adoption of this Taxonomy to identify the issues and gaps encountered** during this first phase of implementation. Based on the findings of this study, the Taxonomy may be revisited, to better align it with this updated Roadmap. First, **its thematic scope could be expanded by including key social activities** and ensuring that critical environmental activities are adequately reflected, for example those related to climate change adaptation. Second, the further elaboration of do-no-harm or minimum safeguards criteria could also be considered.⁵² Third, improving the interoperability of the Sri Lankan taxonomy with those of major partners and investors, such as the EU Sustainable Finance Taxonomy, would also be useful to ease reporting, support comparability and improve the attractivity of Sri Lankan FIs for international sustainable capital.

⁵¹ op. cit.

⁵² Beyond the general principles already mentioned in the current version of the taxonomy.



5.3 Enhancing ESG tools and systems to support reporting

Quality ESG reporting relies on the availability of relevant frameworks, data, tools and systems. In that area, a useful action would be to support a **systematic tagging of loans and underlying asset collateral** according to their sustainability attributes (e.g. green, climate, social, etc.), using the Green Finance Taxonomy as reference for the categorization. This would generate data and insights to improve the tracking of sustainable portfolios within FIs, to streamline and improve reporting (for example, the computation of prudential metrics covering climate or other environmental risks), and to support further impact measurement at portfolio level. This action was already highlighted in the background report of the Green Finance Taxonomy⁵³: “Banks are required to refer to the taxonomy to “identify and tag” their green-loan assets, which aggregate to their green credit or loan statistical data at the bank level, before submitting the information to financial regulators to track their annual performance”. Sri Lanka could build on existing initiatives from large EU banks, among other initiatives. In Nigeria, for example, a review of green tagging in the banking sector has been conducted as

a follow-up to its sustainable finance roadmap published in 2018.⁵⁴ **An initial scoping and feasibility study could be conducted on green or sustainable tagging**, especially looking at the practical implications of these systems for Sri Lankan banks. This study may be followed by a pilot-phase with selected voluntary FIs, before a progressive roll-out to the entire sector, which would require the preparation of specific guidelines or an update to existing E&S and disclosure requirements.

On the longer term, leveraging the possibilities offered by Fintech could be explored, particularly in relation to: i) standardization and automatization of ESG scoring procedures; ii) creation of ESG indexes; iii) environmental impact calculations (e.g. carbon accounting); iv) automatic matching of investments/projects with social and green taxonomies, and; v) efficient matching between project supply and demand, for example through e-platforms. These innovations could be tested at small-scale, before an eventual scale-up.

5.4 Beyond compliance: reporting on impact

The financial sector is starting to move beyond ESG risk management and disclosure to **measuring and reporting on sustainability impact**. While this involves higher complexity and costs, as it requires detailed information

sources and solid skills in impact measurement and modelling, encouraging these initiatives could further improve market transparency and support the positioning of FIs in Sri Lanka as frontrunners on sustainable finance.

⁵³ Central Bank of Sri Lanka (2022). Sri Lanka Green Finance Taxonomy – Background Report.

⁵⁴ CBI et al. (2022). Nigeria Tagging Green Banking Review. February 2022.

This, in turn, contributes to attract further funding - including international capital - to address the country's social and environmental goals e.g. through sustainable bonds or blended finance structures.

Examples of impact metrics include company-wide sustainability indicators, such as ESG indexes, carbon footprint assessments (including through the accounting of Scope 3 emissions) as well as portfolio-level impact assessment (e.g. on GHG or biodiversity), among others. These initiatives are generally conducted by FIs that have clear sustainability targets (e.g. net zero etc.) and commitments to report on those to their clients, shareholders and internally. In Sri Lanka, very few FIs have conducted a comprehensive assessment of their carbon

emissions, in support to carbon-neutrality targets.⁵⁵ Elsewhere, examples of FIs that are leading in this field include ABN AMRO (among others), which assessed the impact of its activities and investments on biodiversity.⁵⁶ It is also worth mentioning that the SBFN is currently developing a list of Key Performance Indicators (KPIs) to support FIs measure, track and report on their impact.

These more sophisticated impact measurement and reporting initiatives may be reviewed at a later stage, leveraging best practices from frontrunners in Sri Lanka and assessing the extent to which they could be extended to the rest of the financial sector through guidance documents and capacity-building.

⁵⁵ BOC is one of the few FIs that conducted such an assessment, covering Scope 1, 2, 3 and 4 emissions and meeting the requirements of ISO 14064-1:2018.

⁵⁶ ABN AMRO (2021). ABN AMRO's impact on biodiversity.

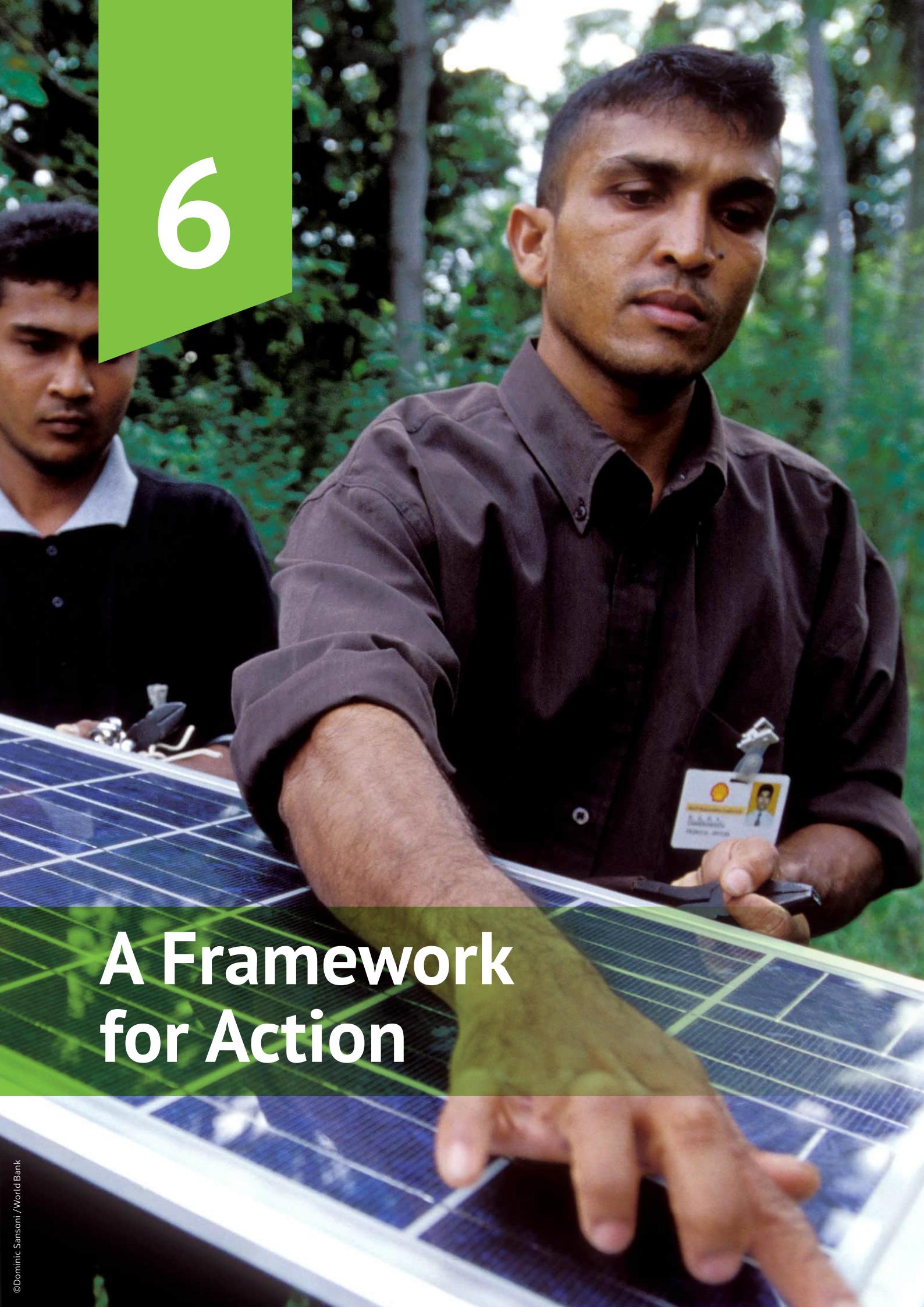


Key Points

1. Clear **supervisory guidance is needed on how FIs can effectively implement SLFRS S1 and S2 standards** to accompany them in the progressive roll-out of these new sustainability disclosure standards aligned with international best practices (IFRS).
2. The Green Finance Taxonomy is a key tool for ESG reporting and disclosure. Based on the findings of an assessment study covering its first few years of implementation, the Taxonomy could be strengthened by **expanding its scope to social categories**, enhancing guidance on **do-no-harm criteria or minimum safeguards** and improving **interoperability and comparability with taxonomies in major markets**.
3. A **scoping and feasibility study on sustainable or green tagging of loans and underlying asset collateral** could be conducted, followed by a pilot-phase and guidelines on sustainable tagging, to foster the adoption of the Green Finance Taxonomy and the generation of data and insights on sustainable finance.

6

A Framework for Action



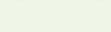
The purpose of this section is to present a clear, realistic, prioritized and phased implementation plan. This section also exposes the approach proposed to effectively monitor the implementation of the priority actions.

6.1 Priority actions and implementation plan

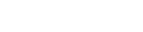
The priority actions presented here were identified based on:

- **Relevance:** actions that contribute to key sustainable development priorities of Sri Lanka.
- **Impact:** actions through which FIs can have a significant impact or contribution.
- **Measurability:** actions that can be effectively tracked by the relevant stakeholders.
- **Readiness:** especially at local level, as the effective implementation of the actions is critically determined by the local context. This criterion can be broken down into 1) Technology and market readiness, 2) Data and information readiness, and 3) Capacity readiness (human, infrastructure and other resources).

The implementation plan proposed here covers the period 2025-2029.

FUNDING SUSTAINABLE DEVELOPMENT									
	Actions	Action Items	Status	Key Stakeholders	2025	2026	2027	2028	2029
1	Develop the regulatory framework on sustainable lending	a. Prepare guidelines for FIs on sustainable loans, deposits and leasing	Ongoing	CBSL					
		b. Conduct awareness-raising and training sessions for FIs on sustainable lending products	New	CBSL, SLBA, FHA					
		c. Promoting Inclusive Green Finance (IGF), with particular emphasis on MSMEs (Implementation of National Financial Inclusion Strategy - Phase II)	New	CBSL					
2	Support the development of the sustainability segment of capital markets	a. Develop a framework for sustainable corporate bonds issuances	Ongoing	SEC					
		b. Provide training and capacity-building to FIs on ICMA-aligned sustainable bond issuances	Ongoing	SEC					
		c. Conduct a scoping study on sustainability indices for the stock market	Ongoing	SEC					
3	Prepare a package of incentives for sustainable finance	a. Conduct a study on the opportunity of introducing regulatory incentives for sustainable lending	New	CBSL, SEC					
		b. Explore and propose incentive schemes for sustainable bond issuances	Ongoing	SEC					
		c. Conduct a review of best practices on reward and recognition schemes for sustainable finance	New	SLBA, FHA					
4	Develop the regulatory and policy framework on sustainable insurance	a. Conduct a scoping study on innovative environmental insurance products, such as index-based climate insurance	Ongoing	IRCSL					
		b. Develop a disaster risk strategy for insurance sector	New	IRCSL					
		c. Prepare regulations on sustainable insurance against natural risks	New	IRCSL					

MANAGING E&S RISKS									
Actions	Action Items	Status	Key Stakeholders	2025	2026	2027	2028	2029	
1 Develop guidance on E&S risk management	a. Conduct a situational study on E&S risk management and identify capacity-development needs	New	CBSL, SEC, SLBA, FHA						
	b. Upgrading or issuing new regulations to reflect strengthened E&S guidelines and requirements for relevant entities	Ongoing	CBSL, SEC, SLBA, FHA						
2 Support the capacity to identify and manage E&S risks	a. Conduct training on climate change data, risks and modelling (with support from relevant partners/networks)	New	CBSL, SEC, SLBA, FHA						
	b. Conduct training on the implementation of E&S tools and procedures (e.g. ESMS)	Ongoing	CBSL, SEC, SLBA, FHA						
3 Develop the regulatory framework on E&S management	a. Prepare a strategy for a progressive introduction of E&S metrics in the supervisory framework for relevant entities	New	CBSL, SEC, SLBA, FHA						
	b. Upgrading of the Banking Act Regulations to reflect strengthened E&S guidelines and requirements	New	CBSL, SLBA						

REPORTING AND DISCLOSURE									
Actions	Action Items	Status	Key Stakeholders	2025	2026	2027	2028	2029	
1 Improve the Green Finance Taxonomy	a. Conduct an industry-wide study on the adoption of the Green Finance Taxonomy to identify the issues and gaps encountered	New	CBSL, SEC, IRCSL, SLBA						
	b. Expand the existing Green Finance Taxonomy to cover social activities, to provide further guidance on DNSH and minimum safeguards, as well as interoperability with other taxonomies	Ongoing	CBSL, SEC, IRCSL						
2 Support the capacity of FIs in adopting reporting and disclosure practices aligned with international standards	a. Provide guidance for FIs on the implementation of SLFRS S1 and S2 standards	New	CBSL, SEC, CSE, IRCSL						
	b. Introduce E&S disclosure guidelines	Ongoing	CBSL, CSE, IRCSL						
	c. Require to disclose the sustainable finance strategies and E&S data at corporate or asset level on regular basis	Ongoing	CBSL, CSE, IRCSL						
3 Support data and procedures for quality reporting and disclosure practices	a. Conduct a scoping and feasibility study on sustainable or green tagging of loans and underlying asset collateral	New	CBSL, SLBA						
	b. Introduce a statistical system and procedures to track sustainable finance flows	Ongoing	CBSL						
	c. Conduct a scoping study of the Fintech solutions that could support the development of sustainable finance	New	CBSL						

GOVERNANCE AND COORDINATION									
Actions	Action Items	Status	Key Stakeholders	2025	2026	2027	2028	2029	
1 Reconstitute the current stakeholder committee on the implementation of SF RM in Sri Lanka to oversee the implementation of the roadmap, its monitoring, coordinate actions, communicate and share knowledge among FIs	a. Develop TOR of the committee reconstituted	New	CBSL						
	b. Recognize key contact points representing key stakeholders identified in the SF RM	New	CBSL						
2 Set up thematic working groups that will oversee the implementation of actions and coordinate capacity-building actions across the different themes.	a. Develop TOR for Thematic WG #1: Products and Innovation	New	CBSL, relevant stakeholders						
	b. Develop TOR for Thematic WG #2: ESG & Climate Risks	New	CBSL, relevant stakeholders						
	c. Develop TOR for Thematic WG #3: Reporting and Disclosure	New	CBSL, relevant stakeholders						

6.2 Progress monitoring system

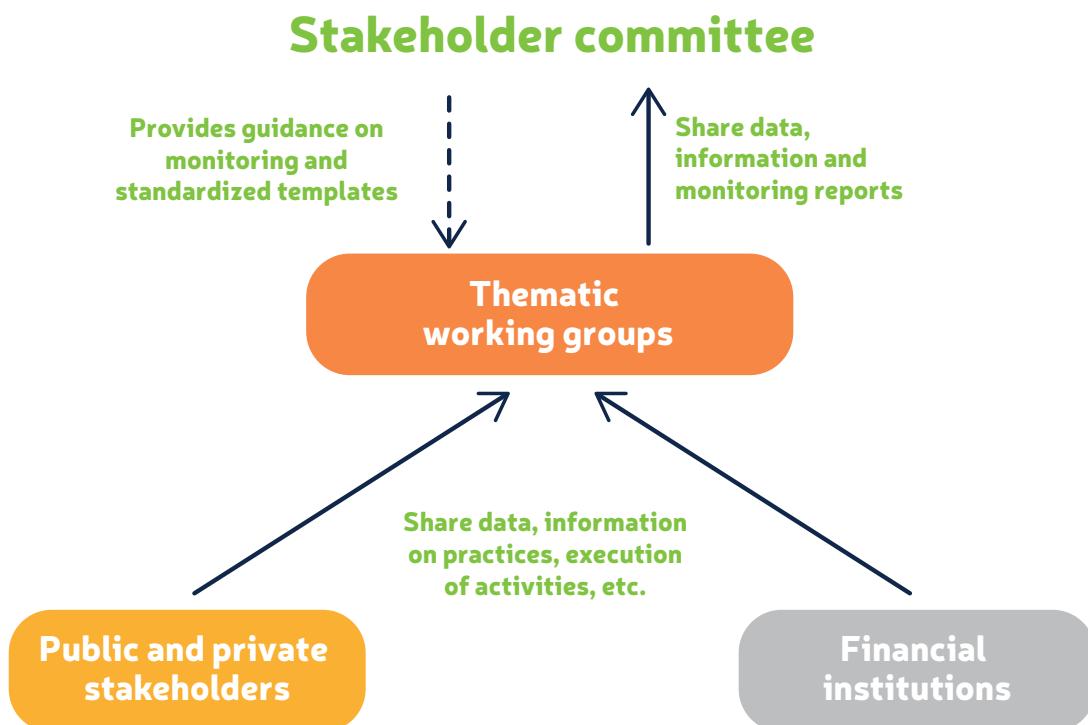
The proposed monitoring framework adopts a nuanced traffic-light system (red – yellow – light green – green) to better reflect the different levels of implementation which are difficult to capture using a 1/0 binary approach. This approach allows to efficiently track the execution of the activities as well as to reflect the potential challenges and innovations that will emerge along the way and feed the implementation through a continuous learning process. A streamlined data collection system is also proposed, leveraging the use of common templates and standardized procedures.

The proposed frequency for the monitoring is every 6 months and the following responsibilities have been identified for the different process:

- **Overall coordination:** Stakeholder committee on the implementation of the Sustainable Finance Roadmap in Sri Lanka (see Action 1 – Governance and Coordination), under the leadership of CBSL.
- **Drafting of monitoring reports:** Thematic working groups (see Action 2 – Governance and Coordination), every 6 months. The monitoring reports for actions on Governance and Coordination will be drafted directly by the Stakeholder committee.
- **Data compilation:** Thematic working groups, mostly through online forms and direct exchanges with relevant entities, at least every quarter.
- **Monitoring meetings:** at least on a quarterly basis for the thematic working groups, bi-annually between the Stakeholder committee and thematic working groups.

The overall information flow for the monitoring process is illustrated by the diagram below:

Figure 3 - Monitoring process



An illustration of monitoring report is given below:

Actions		Responsible	Due date	Level of completion	Assessment	Further actions
1	Conduct a situational study on E&S risk management within FIs and identify capacity-development needs	CBSL	2025			The study has been conducted, leading to useful insights on existing ESG practices and the gaps that remain to be addressed.
2	Conduct trainings on climate change data, risks and modelling for FIs (with support from relevant partners/network)	CBSL	2027			A clear capacity-building plan on climate risks has not been developed and trainings not scheduled yet.
3	Conduct training on the implementation of E&S tools and procedures, such as Environmental and Social Management Systems (ESMS) within FIs	CBSL	2028			Only one training has been conducted so far, while the capacity-building plan indicated two per year.

The signification of the colour codes are detailed below:

-  The action is on track and no issues/challenges have been identified.
-  The action has started but there is a need to address specific issues to ensure it can be completed as planned.
-  The action should have started but hasn't. Quick action is needed to ensure completion on time.
-  The action has not been conducted. The taskforce must assess if there is a need to postpone/reprogram, or if it must be dropped.

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