

DRAFT SECSL Proposed Registration Rules

Produced by FIRST Initiative Consultants

Credit Rating Agencies

DETERMINATIONS TO BE MADE BY THE SECURITIES AND EXCHANGE COMMISSION (SEC) OF SRI LANKA IN TERMS OF PART V OF THE SEC ACT, NO. 36 OF 1987 AMENDED BY ACT, NO.26 OF 1991 AND ACT, NO. 18 OF 2003 (THE ACT)

Introduction

The Act, at Part V of the Schedule details a number of specific requirements for this purpose. However, applicants are reminded that the SEC, *inter alia*, at Part II Section 12 of the Act, is charged with at point b) “the protection of the interest of investors”; and d) “the regulation of the securities market and to ensure that professional standards are maintained in such market”.

In addition, at Part II section 13 point (p) of the Act, in relation to section 12, the SEC “may do all such other acts as may be incidental or conducive to the attainment of the objects of the SEC or the exercise of its powers under this Act.

Accordingly the SEC has determined that in concert with registration requirements for other market intermediaries, the essence of establishing the terms and conditions for the purpose of granting registration/renewal of registration as a credit rating agency are based on four major precepts and that certain conditions should also apply to relevant individuals. The relevant individuals shall mean all directors and employees who will be dealing on behalf of, providing investment advice on or to and making investment decisions for the firm’s clients in relation to securities as defined in the Act. Each firm must have at least two relevant individuals registered with the SEC.

In the case of firms, these are conditions for requirements in relation to: a) financial standings; b) systems capabilities; c) pertinent levels of market knowledge; and d) the fit and proper person test. In addition there are requirements that each firm operates and maintains adequate compliance functions and procedures.

In the case of individuals, these are conditions for requirements in relation to the individual fit and proper person test which includes: a) financial standings; b) pertinent levels of market knowledge; c) demonstration of appropriate capabilities; and d) tests on integrity and honesty. In addition each registered or recorded person will be required to be aware of, and abide by, their firm’s requirement to be committed to compliance functions and procedures.

Section 1

Outline Registration Requirements for Credit Rating Agencies

All Firms must be aware that carrying on the business of a “Credit Rating Agency”, as defined in section 55 of the Act, requires a registration by the SEC. Carrying on such activity without the appropriate registration is an offence.

In particular, at Part II Section 12 of the Act , the SEC is charged with at point b) “the protection of the interest of investors”; and d) “the regulation of the securities market and to ensure that professional standards are maintained in such market”. Therefore, the purpose of the evidential requirements in this registration determination are set in order to meet this aim.

A. Financial Standings

1. Firms will be required to demonstrate that they have sufficient balance sheet and working capital strength to carry out securities business to the degree of risk that they might need to absorb under the circumstances of their type and volumes of activity.
2. Firms will be required to comply with Capital Adequacy Rules issued by the SEC from time to time.
3. Firms will be required to promptly inform the SEC should their financial situation change significantly.

B. Systems Capabilities

1. Firms will be required to have any computer, communications, and contractual arrangements as deemed necessary for the professional execution of their business.
2. These systems may be electronic or manual by method provided that they do not impede the efficiency of the firm’s operations.
3. Firms will be expected to ensure that contractual relationships with clients and suppliers are reasonable and fair.
4. Point 3 shall also include reference to reasonable fees and charges under the circumstances.

C. Knowledge Levels

1. Firms will be required to have sufficient staff numbers and that all relevant persons are adequately qualified for their tasks.
2. Firms will be required to ensure that all their relevant persons are individually registered or recorded with the SEC on behalf of the firm and should notify the SEC promptly of any significant changes.
3. Firms will be expected to organise and effect adequate training for their staff.

D. The “Fit and Proper Person Test”

1. Firms shall be expected to ensure that their business is run with a good standard of honesty and integrity from their directors and staff.
2. Firms shall be expected to comply with any relevant Codes issued for activities within the securities market.
3. Firms shall be expected to ensure that their directors and staff act with diligence and appropriate skill in relation to their stations.
4. Firms shall be expected to treat their clients reasonably and fairly.

E. Operate and Maintain Adequate Compliance Functions and Procedures

1. Firms will be required to operate and maintain compliance procedures and practices to ensure that they do not knowingly breach any laws, regulations, determinations or rules.
2. Where such breaches are discovered by a registered firm, these should be promptly reported to the SEC.
3. Firms will be required to ensure that all relevant members of staff are aware of the compliance requirements and are suitably kept up to date on any significant changes.

Outline Registration Requirements for Relevant Individuals of Credit Rating Agencies

In particular, at Part II Section 12 of the Act , the SEC is charged with at point b) “the protection of the interest of investors”; and d) “the regulation of the securities market and to ensure that professional standards are maintained in such market”. Therefore, the purpose of the evidential requirements in this registration determination are set in order to meet this aim. The essence of this area for individuals is the “Fit and Proper Person Test”. The use of this test by the SEC is particularly designed to ensure that only persons of good integrity and honesty are registered/recorded to carry out securities market business with and for the investing public.

A. Financial Standing

1. Relevant and recorded individuals must not be currently bankrupt. However, for non-directors, other relevant and recorded individuals may, at the approval of the SEC, be permitted registration, or be recorded with the SEC, where they have been discharged from bankruptcy for more than two years.
2. Relevant and recorded individuals should be able to demonstrate that their personal finances are stable and are not subject to unmanageable debts.

B. Pertinent Levels of Knowledge

1. Relevant and recorded individuals should be able to demonstrate that they have appropriate qualifications. Such qualification requirements will be detailed in the rules.
2. Relevant and recorded individuals, where so determined by the SEC, will be required to attain a pass in appropriate regulatory examinations.
3. Practising any activity subject to the Act without appropriate qualifications shall be deemed an offence.
4. Relevant and recorded individuals will be required to have an appropriate level of knowledge in regard to SEC compliance requirements and his/her own firm’s compliance functions and procedures.

C. Competence and Capacity

1. Relevant and recorded individuals must be adequately trained and/or qualified in relation to the tasks designated to them by their firm.
2. Relevant and recorded individuals should only be permitted by their firms to take responsibility for their tasks where this is reasonable under the circumstances.
3. Relevant and recorded individuals should be informed by their firm of their position and relevance in the firm's management structure and hierarchy.

D. Integrity and Honesty

1. Relevant and recorded individuals will be required to demonstrate that they meet high standards of integrity and honesty.
2. Where a relevant or recorded individual's past performance might have brought this into question such past actions must be declared to the SEC.
3. Where past actions of a relevant or recorded individual might have brought these issues into question the SEC may require the individual to explain their past actions.

E. Compliance Responsibility Awareness

1. Relevant and recorded individuals will be required to have an appropriate awareness of SEC and internal compliance requirements.
2. Relevant and recorded individuals shall have a responsibility to acquaint themselves with any of his/her firm's relevant compliance training provisions, including revised and up-dated material.

Section 2

Detailed Registration Rules for Credit Rating Agencies

A. Financial Standings

1. The firm is required to demonstrate that it is a company incorporated under a relevant Companies Act or its equivalent in another jurisdiction.
2. The firm is required to demonstrate that it is of good financial standing.
3. The firm will be required to demonstrate that it has sufficient balance sheet and working capital strength to carry out securities business to the degree of risk that it might need to absorb under the circumstances of its type and volume of activity.
4. The firm is required to demonstrate, on a continuous basis, that it meets any capital adequacy rules established by, or under the authority of, the SEC from time to time. In certain circumstances this may only require the demonstration that it maintains a minimum capital amount or, if it is higher, at least three months cover for operational business expenses.

5. Firms will be required to promptly inform the SEC should their financial situation change significantly.
6. Firms must notify the SEC immediately an event occurs which could lead to the firm being called into liquidation.

B. Systems Capabilities

1. Firms must disclose their Memorandum and Articles of Association or other applicable documentation to the SEC.
2. Permanent and suitable office accommodation should be available with adequate communication facilities, necessary infrastructure and manpower to ensure the discharge of the firm's activities.
3. Firms will be required to have any computer, communications, and contractual arrangements as deemed necessary for the professional execution of their business.
4. These systems may be electronic or manual by method provided that they do not impede the efficiency of the firm's operations.
5. The firm must demonstrate that its organisational structure and hierarchy provide effective management for the business.
6. The firm must demonstrate that it has internal practice manuals sufficient to ensure the continuity of its operational activities.
7. Firms must ensure that their account opening procedures are sufficiently diligent to be satisfied that prospective clients' identities are assured.
8. Firms must adhere to all SEC record keeping rules.

C. Knowledge Levels

1. The firm must be able to declare that the promoters of the credit rating agency are persons who have a special knowledge of matters with which the company may have to deal.
2. Firms will be required to have at least two relevant individuals.
3. Firms will be required to have sufficient staff numbers and that all relevant persons are adequately qualified for their tasks.
4. Firms will be required to ensure that all their relevant persons are individually registered or recorded with the SEC on behalf of the firm and should notify the SEC promptly of any significant changes.
5. Firms will be expected to organise and effect adequate training for their staff.

D. The “Fit and Proper Person Test”

1. The firm’s directors must be able to declare that they have never been bankrupt.
2. The firm’s directors must be able to declare that they have never been persons or been directors of a company whose registration as a market intermediary or licence as a stockbroker, stock dealer or managing company of a unit trust has been cancelled or suspended by the SEC.
3. The firm must be able to declare that no director, officer or employee has been convicted of fraud or criminal breach of trust or cheating or criminal misappropriation or has been declared bankrupt or found guilty of contravening any provisions of the Act or any rules or regulations made under the Act.
4. The firm must be able to declare that the promoters of the credit rating agency are persons of means and integrity.
5. The firm must be able to demonstrate that no director of the firm is a director of a corporate entity or a business firm or shareholder holding five per centum or more of any corporate entity or business firm or is in any other way interested in such an entity subject to rating by the firm.
6. The firm must be able to declare that no director, officer or employee shall communicate the information acquired by them for use of rating purposes, to any other person except when required under the law to do so.
7. Credit rating agencies, under this registration, may not carry out any ancillary activity to that of their main function of providing ratings on issues and issuers without specific permission from the SEC. *It should be appreciated that such permission would only likely be forthcoming where the SEC is undoubtedly convinced that the firm operates most effective “Chinese Walls” to ensure that conflicts of interest would not result.*
8. The firm must be able to demonstrate its organisation’s independence from the companies it rates.
9. The firm must have, and be prepared to demonstrate to the SEC, its ratings procedures. However, the firm may request that such procedures are divulged on an SEC exclusive basis only.
10. The firm, and in particular its directors, must bear responsibility for the compliance of its directors, officers and employees in regard to meeting the individual requirements set out in the detail registration/record requirements for individuals below.
11. Firms will be expected to ensure that contractual relationships with clients and suppliers are reasonable and fair.

12. Point 11 shall also include reference to reasonable fees and charges under the circumstances.

13. Firms shall be expected to ensure that their business is run with a good standard of honesty and integrity from their directors and staff.

14. Firms shall be expected to comply with any relevant Codes issued for activities within the securities market.

15. Firms shall be expected to ensure that their directors and staff act with diligence and appropriate skill in relation to their stations.

16. Firms shall be expected to treat their clients reasonably and fairly.

E. Operate and Maintain Adequate Compliance Functions and Procedures

1. The firm must ensure that it has an adequate compliance policy and issues an internal staff compliance manual to all directors and staff.

2. The firm's compliance procedures must ensure that the credit rating agency does not provide any services which could be considered as ancillary to that of its rating functions, except where appropriate permission has been given by the SEC.

3. In particular the compliance functions must ensure that the firm does not become embroiled in conflicts of interest or activity which might lead to a conflict of interest in terms of its credit rating functions.

4. The firm will be required to operate and maintain compliance procedures and practices to ensure that they do not knowingly breach any laws, regulations, determinations or rules.

5. Where such breaches are discovered by a registered firm, these should be promptly reported to the SEC.

6. The firm will be required to ensure that all relevant members of staff are aware of the compliance requirements and are suitably kept up to date on any significant changes.

7. The firm will be required to have detailed internal rules to manage potential conflicts of interest.

8. The firm should promptly disclose to the SEC the fact and reason why it commences or ceases to rate an issuer.

9. The firm must promptly comply with any reasonable request from the SEC for information which it is entitled to under the law.

10. The firm must have a clear policy in regard to personal dealing, including that of connected persons, in securities of issuers which the firm rates.
11. Firms will be required to maintain an effective complaints process.

Detailed Registration Rules for Relevant Individuals of Underwriting firms

A. Financial Standing

1. Relevant and recorded individuals must not be currently bankrupt. However, for non-directors, other relevant and recorded individuals may, at the approval of the SEC, be permitted registration, or be recorded with the SEC, where they have been discharged from bankruptcy for more than two years.
2. Relevant and recorded individuals should be able to demonstrate that their personal finances are stable and are not subject to unmanageable debts.

B. Pertinent Levels of Knowledge

1. All executive directors and other relevant or recorded individuals who will be dealing with, advising on, and acting on behalf of clients in listed securities should possess the following qualifications:
 - (i) Qualification of Associate of Chartered Accountants of Sri Lanka (ACA), or Associate of the Chartered Institute of Management Accountants (ACMA), or Chartered Financial Analyst (CFA), or Associate of Chartered Certified Accountants (ACCA), or Associate of Chartered Institute of Bankers (ACIB), or Associate of the Institute of Bankers of Sri Lanka (AIB), or an equivalent or higher professional and/or academic qualification acceptable to the SEC, and having at least two years post qualification experience in the securities markets.

or

 - (ii) A proven track record in the securities market field, for at least five years, that is acceptable to the SEC

C. Competence and Capacity

1. Relevant and recorded individuals must be adequately trained and/or qualified in relation to the tasks designated to them by their firm.
2. Relevant and recorded individuals should only be permitted by their firms to take responsibility for their tasks where this is reasonable under the circumstances.
3. Relevant and recorded individuals should be informed by their firm of their position and relevance in the firm's management structure and hierarchy.

D. Integrity and Honesty

1. Relevant and recorded individuals will be required to demonstrate that they meet high standards of integrity and honesty.

2. Where a relevant or recorded individual's past performance might have brought this into question such past actions must be declared to the SEC.
3. Where past actions of a relevant or recorded individual might have brought these issues into question the SEC may require the individual to explain their past actions.
4. Relevant individuals must ensure they observe their firm's required safeguards and do not transact securities business in issuers which their firm rates.
5. Relevant individuals must declare to their firms any event which would represent a significant change in their financial standing, competency, integrity and honesty levels.

E. Compliance Responsibility Awareness

1. Relevant and recorded individuals must ensure that they remain up-to-date with all relevant compliance and regulatory issues.
2. Relevant and recorded individuals shall have a responsibility to acquaint themselves with any of his/her firm's relevant compliance training provisions, including revised and up-dated material.