

DRAFT SECSL Proposed Registration Rules

Produced by FIRST Initiative Consultants

Investment Managers

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

Whilst the Act, at Part V of the Schedule details a number of specific requirements for this purpose, applicants are reminded that the SEC, *inter alia*, under Point A, sub-section (v) of that Part may determine “that the applicant meets any other criteria that may be imposed by the Commission from time to time”.

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 the essence of establishing the terms and conditions for the purpose of granting registration/renewal of registration as a market intermediary 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 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 *inter alia* (i.e. as scheduled under Point B of Part V of the Schedule of the Act) 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 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 Investment Manager Firms

All Firms must be aware that carrying on the business of an “investment manager”, 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.

B. Systems Capabilities

1. Firms will be required to have any computer, communications, dealing, settlement and contractual arrangements as deemed necessary for the professional execution of their business.
2. Firms will be required to ensure that they either have, or have use of, valuation systems which encompass the full array of securities in which they might invest on behalf of clients.
3. These systems (i.e. from points 1 and 2 immediately above) may be electronic or manual by method provided that they do not impede the efficiency of the firm’s operations.
4. Firms will be required to ensure that they obtain and observe relevant investment conditions stipulated by their clients.
5. Firms will be expected to ensure that contractual relationships with clients and suppliers are reasonable and fair.
6. Point 5 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 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 appoint an individual compliance officer.
2. 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.
3. Where such breaches are discovered by a registered firm, these should be promptly reported to the SEC.
4. 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.
5. Firms will be required to make an annual compliance report to the SEC.

Outline Registration Requirements for Relevant Individuals of Investment Manager Firms

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 to carry out securities market business with the investing public.

A. Financial Standing

1. Relevant individuals must never have been declared bankrupt.
2. Relevant 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 individuals should be able to demonstrate that they have appropriate qualifications. Such qualification requirements will be detailed in the rules.
2. Relevant 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 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 individuals must be adequately trained and/or qualified in relation to the tasks designated to them by their firm.
2. Relevant individuals should only be permitted by their firms to take responsibility for their tasks where this is reasonable under the circumstances.
3. Relevant 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 individuals will be required to demonstrate that they meet high standards of integrity and honesty.
2. Where a relevant 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 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 individuals will be required to have an appropriate awareness of SEC and internal compliance requirements.
2. Relevant 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 Requirements for Investment Manager Firms

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. Firms will be required to disclose the names, and percentage holdings, of their holding companies, subsidiary companies, associate companies and partnerships.
4. 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.

5. 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.

6. Firms will be required to promptly inform the SEC should their financial situation change significantly.

7. Firms are required to ensure that all client money and assets are given segregation against the money and assets of the investment management firm. Thus no client money or assets may legally be used to settle the debts of the investment management firm. Firms must be able to demonstrate how they effect this requirement.

8. 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.

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. In particular, firms will be required to ensure that they either have, or have use of, valuation systems which encompass the full array of securities in which they might invest on behalf of clients. Such systems must also be capable of issuing clients with regular portfolio valuations (including notification of all actions taken on the client's account since the previous valuation).

5. These systems may be electronic or manual by method provided that they do not impede the efficiency of the firm's operations.

6. The firm must demonstrate that its organisational structure and hierarchy provide effective management for the business.

7. The firm must demonstrate that its has internal practice manuals sufficient to ensure the continuity of its operational activities.

8. The firm must, prior to accepting a client, provide each client with a questionnaire seeking to ascertain the client's investment requirements, risk tolerance and any restriction conditions.

9. The firm must record the data from point 8 immediately above in an appropriate manner and must ensure that its directors and staff continue to adhere to these factors.

10. Any breach to requirement 8 above ,inadvertent or otherwise, must be rectified without disadvantage to the client.

11. The firm must, prior to accepting a client, provide each client with an Advisory Services Guide which should include at least the following information in a comprehensive manner:

- (a) terms and conditions of business (including fee and commission rates, actions in exceptional circumstances and potential for alterations in these;
- (b) the name of the registered person of the investment manager responsible for providing investment advice, any deputies and/or the method by which changes will be informed;
- (c) the type of investment advice that will be provided;
- (d) actual and potential conflicts of interest between the firm and the client and how potential and new actual conflicts of interest will be informed to the client;
- (e) the manner in which any disputes, the client may have relating to the investment advice will be resolved; and
- (f) any other information tat the investment manager deems appropriate to disclose to the client under the circumstances.

12. Firms must ensure that their account opening procedures are sufficiently diligent to be satisfied that prospective clients identities are assured.

13. Firms must adhere to all SEC record keeping rules.

C. Knowledge Levels

1. Firms will be required to have at least two relevant individuals.

2. Firms will be required to have sufficient staff numbers and that all relevant persons are adequately qualified for their tasks.

3. Firms will be required to ensure that all their relevant persons are individually registered with the SEC on behalf of the firm and should notify the SEC promptly of any significant changes.

4. Firms will be expected to organise and effect adequate training for their staff.

D. The “Fit and Proper Person Test”

1. 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 requirements for individuals below.

2. 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 requirements for individuals below.
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.
5. Firms shall be expected to ensure that their business is run with a good standard of honesty and integrity from their directors and staff.
6. Firms shall be expected to comply with any relevant Codes issued for activities within the securities market.
7. Firms shall be expected to ensure that their directors and staff act with diligence and appropriate skill in relation to their stations.
8. 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 appoint an individual compliance officer.
2. The firm must ensure that it has an adequate compliance policy and issues an internal staff compliance manual to all staff.
3. 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.
4. Firms must ensure that compliance procedures are in place to monitor that investment advice and investment actions are only given and made in line with the data on investment requirements, risk tolerance and any restrictive conditions supplied by clients. These procedures should also monitor for any abuse or unfair treatment in regard to the use of discretion on client portfolios.
5. Where any breaches of laws, rules, regulations or determinations are discovered by a registered firm, these should be promptly reported to the SEC.
6. 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.
7. The firm must promptly comply with any reasonable request from the SEC for information which it is entitled to under the law.

8. The firm must have a clear policy and practices in regard to personal dealing of directors and staff, including that of connected persons, in securities.
9. Firms will be required to maintain an effective complaints process.
10. Firms will be required to make an annual compliance report to the SEC.

Detailed Registration Requirements for Relevant Individuals of Investment Manager firms

A. Financial Standing

1. Relevant individuals must never have been declared bankrupt.
2. Relevant 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 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

and

- (iii) Should have successfully completed the Stockbroker Training Programme conducted by the Colombo Stock Exchange for investment advisers, or an equivalent training programme acceptable to the SEC, unless the SEC has provided the individual with specific exemption from this part. *Such exemption will only be available for a limited period of time.*

C. Competence and Capacity

1. All directors and relevant individuals must be a citizen of Sri Lanka

2. All directors and other relevant individuals where they are a director and/or hold five per centum or more of the equity of a listed company must disclose this fact to their firm and the SEC on a continuous basis.
3. Relevant individuals must be adequately trained and/or qualified in relation to the tasks designated to them by their firm.
4. Relevant individuals should only be permitted by their firms to take responsibility for their tasks where this is reasonable under the circumstances.
5. Relevant individuals should be informed by their firm of their position and relevance in the firm's management structure and hierarchy.
6. Directors must declare that they have never been a person or been a director of a company whose registration as a market intermediary or licence as a stock broker, stock dealer or managing company to a unit trust has been cancelled or suspended by the SEC.

D. Integrity and Honesty

1. Relevant individuals will be required to demonstrate that they meet high standards of integrity and honesty.
2. Where a relevant 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 individual might have brought these issues into question the SEC may require the individual to explain their past actions.
4. 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 individuals must ensure that they remain up-to-date with all relevant compliance and regulatory issues.
2. Relevant 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.