Terms of Reference

Expertise to Guide the Implementation of a Delivery vs. Payment Framework and Recommend a Policy Framework for Implementing a Central Counterparty System

1. Background

The Securities and Exchange Commission of Sri Lanka (SEC) was established in pursuance of the Securities and Exchange Commission of Sri Lanka Act, No 36 of 1987 as amended by Act no. 26 of 1991, Act no. 18 of 2003 and Act no. 47 of 2009 and is located at 28th/29th floors, East Tower, World Trade Center, Colombo 01. The SEC is the regulatory body entrusted with the regulation of stock exchanges, stock brokers, stock dealers, the unit trust industry and market intermediaries consisting of underwriters, margin providers, credit rating agencies, investment managers and clearing and depository houses.

The Colombo Stock Exchange (CSE) operates an Automated Trading System (ATS) to trade shares of listed companies, corporate debt securities, and beneficial interest of government securities and units of Closed-end-Funds. The Central Depository Systems (Pvt.) Ltd. (CDS), a wholly owned subsidiary of the CSE, functions as the ‘depository’ to the CSE. The settlement for equity traded by the ATS is on T + 3 and the market operates on a non DvP environment where the buyer is given instant credit for purchases in the depository and sellers are paid only on T + 3. Therefore, a significant asset commitment risk and counterparty risk exist in the current system.

1.1. World Bank’s Financial Sector Modernization Project (FSMP)

Under the FSMP, SEC stands to gain funding for strengthening of its supervisory and regulatory capacity. As such, specific Consultancy assistance under the project to provide technical assistance for the implementation of a DvP mechanism with the view of implementing a CCP in the long term was envisaged as being crucial for developing the Sri Lankan Capital market.
A well designed DvP settlement model leading up to a CCP system with an appropriate risk management mechanism will address the asset commitment and settlement risk presently prevalent in the current Sri Lankan capital market. As such, the SEC is facilitating the implementation of this priority initiative under the FSMP.

Initially, the financial case for setting up of a CCP settlement mechanism was evaluated and it was decided to adopt a phased approach considering the prevalent trading volumes in the market. As such, priority was given to **DvP implementation together with a suitable risk management mechanism as the initial phase of the project.** Upon having extensive consultation sessions with the CSE and the other stakeholders, the business and operational specifications of a DvP and enhanced margining system were finalised and approved by the Commission. Accordingly, the CSE has been instructed to commence the implementation process.

**Objectives of the Consultancy**

The Consultancy assignment broadly aims to review and enhance the proposed DvP and risk management system and guide the implementation process. The Consultant is also expected to improve the policy framework, and formulate policy for implementation of a CCP mechanism with Regulated Short Selling and Securities Borrowing and Lending in line with international best practices.

**2. Scope of the Project**

The Consultant/ is expected to provide expertise in relation to the following areas:

- Reviewing the business and operational specifications of the proposed DvP and risk management system in relation to the adequacy of the same to address a settlement failure, guiding the implementation process and developing policy framework acceptable to all stakeholders for the implementation of the proposed CCP considering the option of having an integrated CCP jointly with the Central Bank of Sri Lanka (CBSL)
The proposed DvP and CCP shall be compliant with recommendations for Central Counterparties made by the Task Force on Securities Settlement Systems jointly established by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO).

Enhance the policy for introducing Regulated Short Selling and Securities Borrowing and Lending.

3. Project Deliverables

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<tr>
<th>Deliverable</th>
<th>Description</th>
<th>Tentative Time period</th>
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<tbody>
<tr>
<td>Inception Report</td>
<td>• Inception report should provide the expert’s preliminary findings of the proposed DvP system, a project plan, including how the expected deliverables are delivered with any anticipated limitations.</td>
<td>1 Month</td>
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<td>Interim Reports</td>
<td>• Reviewing of the business and operational specifications of the DvP model and proposed risk management mechanism, comment and provide necessary enhancements.</td>
<td>6 Months</td>
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<td>• Reviewing of draft DvP rules and regulations and providing recommendations for further improvements.</td>
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<td>• Review and propose improvements to the Business Continuity Plan for DvP.</td>
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<td>• Guide the implementation process of the DvP, enhanced margining system proposed by the CSE and review and enhance the proposed risk management mechanism to mitigate settlement failures.</td>
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<td>• Review the previous studies conducted on DvP.</td>
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and CCP and provide recommendations on the applicability and adequacy of same
- Identifying and recommend on system modifications and other requirements (capital adequacies, risk management measurers) that need to be fulfilled by the CSE and Stock Broking Firms
- Assisting in stakeholder consultation, providing recommendations on addressing concerns/matters raised by stakeholders
- Monitor and review the project until the successful implementation of DvP, provide recommendations for submissions to the Commission and assisting in coordinating with all stakeholders where relevant

| Policy framework for CCP, Regulated Short Selling & Securities Borrowing and Lending | Formulating the policy framework for proposed CCP implementation and designing of the business specifications for the same considering the option of having an integrated CCP for all financial transactions jointly with the CBSL
- Recommending a structure for the clearing house taking into account the requirements of all stakeholders
- Reviewing the draft policy for Regulated Short Selling and Securities Borrowing and Lending and providing recommendations on the adequacy and further enhancements to the same
- Providing recommendation in relation to all areas relevant to the deliverable in terms of the international best practices and standards | 2 Months |
| Staff Training | • Provide training by way of sessions (presentations, workshops etc.) conducted by the Expert in relation to technical areas pertaining to the expected deliverables  
• Review and recommend enhancements to the training proposed by the vendor on the proposed system for staff  
• Training on technical areas in relation to Regulated Short Selling and Securities Borrowing and Lending | Ongoing |
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<tr>
<td>Final Report</td>
<td>• Final report to be submitted with recommendations and reports to cover all the deliverables</td>
<td>3 Months</td>
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A review committee is to be appointed to evaluate the outcomes of the Consultancy. The committee shall review and provide feedback on each deliverable. The payments shall be made upon the acceptance of the deliverables by the review committee.

4. Training

- Training on technical areas in relation to risk management framework under a DvP mechanism and basic overview of a CCP settlement system and risk management framework
- Review and recommend enhancements to the training proposed by the vendor on the proposed system for staff
- Training on technical areas in relation to Regulated Short Selling and Securities Borrowing and Lending
5. Data, Personnel, and Facilities to be provided by the client

- Existing studies/policy documents on DvP, CCP, Regulated Short Selling, Securities Borrowing and Lending
- Existing SEC Act
- Proposed SE Bill
- Required stakeholder meetings will be facilitated by the Capital Market Development team

6. Consultants Qualifications and other required Competencies

**Competencies**

- Demonstrated knowledge and experience in implementing a DvP mechanism with exposure to regulatory and operational environment relating to post-trade risk management in line with international standards
- Demonstrated knowledge and experience in developing policy framework for DvP, CCP, Regulated Short Selling and Securities Borrowing and Lending
- Demonstrated experience and skills in training staff
- Relevant regional and international experience will be an added advantage
- Excellent interpersonal skills with the ability to function effectively, collaboratively in a team environment, high integrity and accountability

**Qualifications**

- Bachelor’s Degree in Finance/ Business Management / Economics or related field
  or
- A Professional qualifications such as CPA/CFA/CIMA/ACCA/FRM