



BY HAND

Ref: SEC/LEG/17/08/15

22<sup>nd</sup> August 2017

TO: THE COLOMBO STOCK EXCHANGE

**DIRECTIVE ISSUED IN TERMS OF SECTION 13 (c) OF THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA ACT NO. 36 OF 1987 (AS AMENDED)**

**RE: REVISED PROCEDURE TO BE ENFORCED ON STOCK BROKING COMPANIES TRADING IN EQUITY AND DEBT SECURITIES THAT HAVE FAILED TO ENSURE COMPLIANCE WITH THE RISK BASED CAPITAL ADEQUACY REQUIREMENTS (CAR)**

The Securities and Exchange Commission of Sri Lanka (SEC) at its 394<sup>th</sup> meeting held on 14<sup>th</sup> August 2017 approved the revision of the enforcement procedure (as stated in Annexure A attached hereto) to be applicable to Stock Broking companies that have failed to ensure compliance with the Risk Based Capital Adequacy Requirements.

The Commission approved the revised enforcement procedure subsequent to considering the representations made by the Colombo Stock Exchange (CSE) in order to provide information on the impending regulatory action on the defaulting Stock Broking companies to the clients *prior* to imposing a prohibition on all trading activities of the defaulting company.

The Commission taking cognizance of the aforesaid concerns of the CSE decided to mandate the CSE to take measures to adopt the procedures as set out in Annexure A attached hereto which is a revision of the enforcement procedures that the CSE was previously directed to adopt by way of SEC Directive dated 01<sup>st</sup> August 2017 bearing reference SEC/LEG/17/08/01.

Therefore the Colombo Stock Exchange (CSE) is hereby directed as follows:

- i. to incorporate the revised enforcement procedure appearing in Annexure A attached hereto under Section 5 of the Stockbroker Rules of the CSE to be applicable to all the relevant stock broking companies who violate the Capital Adequacy Requirements in the manner specified in Annexure A;
- ii. once the contents in Annexure A (attached hereto) are incorporated into the Stockbroker Rules as aforesaid, to revert to the SEC for approval in terms of Section 24 of the Securities and Exchange Commission of Sri Lanka Act (SEC Act) No. 36 of 1987 (as amended); and
- iii. to inform all licensed Stock Brokers trading in equity and debt securities of the enforcement procedures as set out in Annexure A to be enforced in the event of non-compliance with the Capital Adequacy Requirements, pending incorporation to the Stockbroker Rules of the CSE.

This Directive shall be effective from the date hereof.

Annexure A attached hereto shall form part and parcel of this Directive.

The SEC Directive dated 01<sup>st</sup> August 2017 bearing reference SEC/LEG/17/08/01 is hereby repealed.



Vajira Wijegunawardane  
**DIRECTOR GENERAL**

Encl.: Annexure A

## **ANNEXURE A**

### **5.4 NON-COMPLIANCE WITH CAPITAL REQUIREMENTS**

#### **5.4.1 NON-COMPLIANCE WITH THE MINIMUM CAPITAL ADEQUACY REQUIREMENT/S**

(1) If a Stockbroker Firm referred to in Rule 5.1.1 above, fails to meet the minimum Capital Adequacy Requirement/s;

(a) five (05) times within a period of thirty (30) calendar days commencing from the first non-compliance; or

(b) seven (07) times within a period of three (03) months commencing from the first non-compliance;

whichever is earlier, the Chief Executive Officer of the CSE or any person acting on his behalf shall prohibit the Stockbroker Firm concerned from carrying out any purchase of Securities and shall inform the SEC of such prohibition.

(2) The CSE shall keep the SEC informed of all subsequent action regarding the failure of the Stockbroker Firm to meet the minimum Capital Adequacy Requirement/s at least on a fortnightly basis.

#### **5.4.2 PROCEDURE TO BE ENFORCED IN RELATION TO NON COMPLIANCE WITH CAPITAL ADEQUACY REQUIREMENT/S.**

(1) Commencing from the date of prohibition from carrying out any purchase of securities imposed by the CSE referred to in Rule 5.4.1 (1) above, the Stockbroker Firm shall, until it is permitted to resume all trading activities as provided for in Rule 5.4.2 (5) below, report the following to the CSE:

On a daily basis:

(a) Schedule of the creditors to whom settlement cheques were issued

(b) Position of Client Funds against the creditors over T+3 balance

On a weekly basis (on the last trading day of the week):

(c) Settlement of creditors over T+3 Days, together with the reconciliation of realisation of cheques

(2) The Stockbroker Firm will be granted a period of one (01) month from the date it is prohibited from carrying out any purchase of securities as per Rule 5.4.1 (1) above in order to comply with the minimum Capital Adequacy Requirement/s.

In granting the aforesaid period of one (01) month, the CSE shall request the Stockbroker Firm to submit a time-bound capital augmentation/rectification plan approved by its Board, outlining in broad terms the capital planning process, the time period for achieving the stated objectives and the measures initiated on how the Stockbroker Firm intends to ensure compliance with Capital Adequacy Requirement/s.

- (3) In the event the Stockbroker Firm fails to comply with the minimum Capital Adequacy Requirement/s within the period of one (01) month granted in terms of Rule 5.4.2 (2) above, the following measures shall take effect on such Stockbroker Firm.
- (a) The CSE shall publish a notice within three (03) market days from the end of the one (01) month period granted in terms of Rule 5.4.2 (2) in all three languages in daily newspapers, indicating the non-compliance with the applicable Rules and the enforcement action taken by the CSE.
  - (b) The CSE shall require the defaulting Stockbroker Firm to facilitate the smooth transfer of portfolios of the clients of the Stockbroker Firm to other Stockbroker Firms/Custodian Banks, upon obtaining the consent of the respective clients.
  - (c) Subsequent to measures initiated by the CSE as specified in terms of Rule 5.4.2 (3) (a) above the CSE shall prohibit such Stockbroker Firm from carrying out all trading activities at the end of seven (07) market days from the date of publication of the aforesaid notice in the daily newspapers and require such Stockbroker Firm to take the following measures with immediate effect.
    - (I) Prohibit canvassing and accepting new clients.
    - (II) Settle creditors over T+3 balances and investor advances and ensure that sales proceeds of investors are settled on time and not retained.
- (4) The Stockbroker Firm shall be granted a further period of two (02) months from the expiry of the period granted under Rule 5.4.2 (2) above, subject to the submission of a revised capital augmentation/rectification plan which is acceptable to the CSE.
- (5) The Stockbroker Firm will be permitted to resume all trading activities no sooner it complies with the minimum Capital Adequacy Requirement/s and such other minimum standards as applicable to the Stockbroker Firm under Stockbroker Rules.
- (6) If the Stockbroker Firm fails to comply with the minimum Capital Adequacy Requirement/s upon the expiry of the period granted under Rule 5.4.2 (4) above, the Board of Directors of the CSE shall suspend the membership of the Stockbroker Firm in terms of Article 20 of the Articles of Association of the CSE, unless the CSE decides to waive such suspension with the approval of the SEC, subject to such conditions as the SEC may deem appropriate.
- (7) In the event the purchases of the Stockbroker Firm is suspended under Rule 5.4.1 (1) above on three separate occasions the CSE shall notwithstanding the passage of time between each such suspension take steps to suspend the membership of the Stockbroker Firm forthwith, in terms of Article 20 of the Articles of Association of the CSE.