

**Media Release**

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**Adoption of a Risk Based Capital Adequacy Requirement**

The Securities and Exchange Commission of Sri Lanka (SEC) on the recommendation of the Colombo Stock Exchange (CSE), directed the implementation of a risk based Capital Adequacy Requirement (CAR) of 1.2 times the risk requirement of stockbrokers subject to a minimum liquid capital requirement of Rs 35 Mn. The CAR Rules are applicable to all stockbroker firms excluding those licensed to deal only in debt securities, with effect from 1 March 2017.

The current Rules on minimum Net Capital applicable to stockbroker firms do not address the different risks these firms are exposed to. In the light of the foregoing limitations of the present Rules and in keeping with international standards a dire need to establish a risk-based capital adequacy requirement was felt. Having considered the capitalisation of stockbroker firms, their current activities and CAR regimes implemented in regional markets, the CSE together with the SEC developed the methodology for the Rules.

The International Organization of Securities Commissions (IOSCO), which is the global standard setter for the securities sector sets out Principles of securities regulation and its members including SEC Sri Lanka are expected to implement these Principles in order to achieve the objectives of securities regulation i.e. protect investors, ensure that markets are fair, efficient and transparent and reduce systemic risk.

The regulatory Principle 30 states that “There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.” This Principle identifies that capital must be sufficient to protect a financial institution’s customers and counterparties from various risks. In addition, an efficient capital adequacy structure is able to send timely warning signals to intermediaries to reassess their risk management practices, as a decline in the capital base can expose the intermediary to significantly higher levels of risks. Moreover, in order to ensure efficient functioning of capital markets it is imperative for all participants to have confidence in each other’s stability and the ability to effectively manage risk. The inability of an intermediary to honour his commitment can lead to serious market disruption and decline in investor confidence.

The CAR requirement will meet IOSCO Principle 30 by defining and enabling the monitoring of risk on a daily basis and linking the capital required to be maintained to address risk. Furthermore, the implementation of CAR will enable the SEC and the CSE to set up trigger points and prompt brokers to proactively monitor and manage their CAR before it breaches the minimum threshold. CAR will also aid in the development a risk based supervision framework.

This proactive approach will encourage stockbrokers to conduct their business operations more professionally and thereby help foster investor confidence in the capital market.

**Issued by**

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