SEC
SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA
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22 NOV 2016
CEO'S OFFICE
(CSE)

BY HAND

Ref: SEC/LEG/16/11/20

22nd November 2016

To: All Licensed Stock Brokers excluding those Licensed Only to Trade in Debt Securities
The Colombo Stock Exchange

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

<u>RE: MANDATORY IMPLEMENTATION OF RISK BASED CAPITAL ADEQUACY REQUIREMENTS</u>

The Securities and Exchange Commission (SEC) at its 378th Meeting held on 8th November 2016 approved the implementation of Rules for the maintenance of Minimum Capital Adequacy Requirements by all licensed Stock Brokers excluding those licensed only to trade in debt securities.

The Rules require all Stock Brokers excluding those licensed only to trade in debt securities to maintain a Minimum Capital Adequacy Ratio of 1.2 subject to a Minimum Liquid Capital of Rs. 35 million. The methodology for calculation of the Capital Adequacy Ratio and for the determination of Liquid Capital is provided in the Rules.

Therefore, all Stock Brokers excluding those licensed only to trade in debt securities are hereby directed to adopt and maintain the Minimum Capital Adequacy Requirements detailed in Annexure I with effect from 1st March 2017.

The Colombo Stock Exchange is hereby directed to:

1) implement the annexed Rules with effect from 1st March 2017;

2) incorporate the aforesaid Rules into the Stock Broker Rules of the CSE; and to

3) inform all Stock Brokers excluding those licensed only to trade in debt securities of this Directive.

Vajira Wijegunawardane
DIRECTOR GENERAL
AA/SP

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Pls Circulate
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Encl.: Rules to Facilitate the Implementation of the Capital Adequacy Ratio – Annexure I

28 සහ 29 මහල, නැගෙනහිර කුළුණ, ලෝක වෙළඳ මධ්‍යස්ථානය, එච්ලන් චතුරශ්‍රය, කොළඹ 01.
28 மற்றும் 29 ஆம் மாடி, உலக வர்த்தக மையம் கிழக்கு கோபுரம், எச்சலன் சதுக்கம் கொழும்பு 01.
Level 28 & 29, East Tower World Trade Center Echelon Square, Colombo 01, Sri Lanka.

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ANNEXURE I

RULES TO FACILITATE THE IMPLEMENTATION OF THE CAPITAL ADEQUACY RATIO (CAR)

1. Minimum Capital Adequacy Requirements

The firms shall, at all times, maintain the minimum Capital Adequacy Requirements subject to the terms and conditions set out below:

(a) A Stockbroker trading in equity and debt shall maintain a minimum Capital Adequacy Ratio of 1.2 computed in accordance with Annexure A of these Rules, subject to maintaining a minimum liquid capital of Rs. 35 Mn.

(b) A Stock Broker and/or Stock Dealer permitted to trade only in Debt Securities, other than a Primary Dealer licensed by the Central Bank of Sri Lanka, shall maintain a minimum Net Capital as shall be determined by the Board of Directors of the CSE from time to time.

(c) Primary Dealers licensed by the Central Bank of Sri Lanka shall not be required to comply with the minimum Capital Requirements set out in these Rules.

2. Procedure for Maintaining the Minimum Capital Adequacy Requirements

(a) The Value at Risk (VaR) margin value of each security listed on the CSE shall be provided to all Stockbroker Firms by the CSE on a monthly basis.

The VaR margin shall be calculated by the CSE based on the methodology determined by the Board of Directors of the CSE from time to time.

(b) A Stockbroker shall compute its Capital Adequacy Requirements for each Market Day based on the VaR margin values provided by the CSE in terms of Rule 2 (a) above and notify same to the CSE and SEC on a daily basis, not later than 09:00 hours on the following Market Day, in accordance with the procedure specified by the CSE and SEC for such purpose from time to time.

(c) The Stockbroker Firm shall ensure that the Capital Adequacy Requirements are notified to the CSE and SEC in terms of Rule 2 (b) above by the Chief Executive Officer or any other person duly authorized by the Stockbroker Firm for such purpose.

(d) In the event the Capital Adequacy Requirements of the Stockbroker Firm falls below the minimum as prescribed in Rule 1 (a) above on a particular Market Day, such Stockbroker Firm shall:

(i) notify CSE and the SEC in writing, the manner in which such Stockbroker Firm intends to increase its minimum requirements, not later than 09:00 hours on the date referred to in 2 (b).

(ii) take necessary steps to meet the minimum Capital Adequacy Requirements by the end of the Market Day immediately following the date of notifying the CSE and SEC in terms of Rule 2 (b).

3. Non-Compliance with the Minimum Capital Adequacy Requirements

(a) If a Stockbroker Firm referred to in Rule 1 (a) above, fails to meet the minimum Capital Adequacy Requirements:

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

(ii) 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 from carrying out any purchase of securities and shall inform the SEC of such prohibition.

(b) The ability to carry out purchase of securities will be permitted upon compliance by the Stockbroker with the minimum Capital Adequacy Requirements.

(c) In the event the Stockbroker Firm fails to comply with the minimum Capital Adequacy Requirements for a period of one (01) month from the date of prohibition from carrying out any purchase of securities, then the matter will be referred to the Board of Directors of the CSE for necessary action and the Board of Directors of CSE shall inform the SEC of the decision of the Board together with reasons for same.

ANNEXURE 'A'

METHODOLOGY TO CALCULATE THE CAPITAL ADEQUACY RATIO

A Stockbroker Firm shall calculate the Capital Adequacy Ratio by dividing the Liquid Capital of the Stockbroker Firm by the Total Risk Requirement of such Firm as illustrated below:

$$\frac{\textbf{Liquid Capital of the Stockbroker Firm}}{\textbf{Total Risk Requirement of the Stockbroker Firm}}$$

A Stockbroker Firm shall exclude all Custodian purchase/s of Securities carried out by such Firm from the above computation, except in instances where the settlement liability is transferred to the Stockbroker Firm pursuant to a trade rejection by a Custodian Bank.

For the purposes of these Rules:

'Liquid Capital' shall be determined by the Stockbroker Firm by deducting all fixed and non-liquid assets and contingent liabilities of the Stockbroker Firm from the Firm's capital employed as follows:

Liquid Capital	=	**Firm's Capital Employed** Note 1	***less***	[**All Fixed and Non-Liquid Assets** Note 2 + **Contingent Liabilities**]

Note 1 Firm's Capital Employed will include:

- Shareholder's Funds
- Long Term Loans (with a period to expiry of at least 1 year from the reporting date)
- Long Term Debentures issued with no call options (with a period to maturity equal to or greater than one [1] year)

Subject to shareholder's funds being greater or equal to 50% of the total Capital Employed

Note 2 All Fixed and Non-Liquid Assets including but not limited to:

- Property Plant and Equipment
- Intangible Assets
- Investments in unlisted Equity shares
- Related Party Receivables
- Client Receivables (in excess of the portfolio value adjusted for VaR margin)
- Prepayments
- Unsecured Loans given
- Other loans including staff loans (exposure in excess of the value of security)
- Deferred Tax Assets
- Advances
- Liquidity Deposit provided to the CSE
- Other Assets which are doubtful of collection, less provision made

'Total Risk Requirement' shall be determined by the Stockbroker Firm taking into consideration the following Risks:

(a) **'Operational Risk'**, which shall be computed as;

twenty five per centum (25%) of the annual expenditure of the Stockbroker Firm based on:

i) the latest available Audited Financial Statements of the Firm, excluding any non recurring expenditure; <u>or</u>
ii) the monthly financial statements of the Firm for the twelve (12) months immediately preceding the particular month excluding any non recurring expenditure;

whichever is greater

(b) **'Counterparty Risk',** shall be computed as the total client receivable balance resulting from purchase transaction/s in excess of the marked to market value of the client's securities portfolio, value adjusted for VaR margin less deposits with the CDS as stipulated in the CDS Rules, excluding purchase transactions captured under Large Exposure Risk. The Counterparty Risk shall not be less than Zero.

(c) **'Large Exposure Risk',** shall be computed as the cumulative client receivable balance resulting from purchase transaction/s equal to or over Rupees One Hundred million (Rs. 100,000,000/-) each in excess of the marked to market value of the said purchase transaction/s adjusted for VaR margin less deposits with the CDS as stipulated in the CDS Rules. The Large Exposure Risk shall not be less than Zero.

(d) **'Position Risk',** shall be computed as the total outstanding balance resulting from the purchase transaction/s carried out by the Firm on its Own Account in excess of the marked to market value of the said purchase transaction/s adjusted for VaR margin less deposits with the CDS as stipulated in the CDS Rules. The Position Risk value shall not be less than Zero.