

Guidelines on Fitness and Propriety



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Chapter 1

General

1.1 Introduction

The *SEC* believes that maintenance of fit and proper standards are essential to ensure that business activities in the securities market are conducted with high standards of market practice and integrity.

This fitness and propriety regime primarily strives to fulfill a gatekeeper role ensuring that key positions of the *regulated entities* possess the required level of competence and integrity.

The assessment is undertaken initially when an application is considered for licensing or registration, and also on a continuous basis which takes into account the ongoing conduct of business and the history of compliance with all applicable laws and regulations.

The fitness and propriety of the top management of *regulated entities* are critical to the achievement of the objectives of supervision. The primary responsibility for ensuring that the *regulated entities* are prudently and soundly managed and directed rests with the *regulated entities* themselves. It is the expectation of the *SEC* that the entities will take measures necessary to ensure that managers, directors and shareholders who exercise significant influence on their operations meet the fitness, propriety or other qualification tests of the regulator.

The onus is on the *regulated entity* to establish that it or he is a fit and proper person rather than for *SEC* to show otherwise.

These Guidelines provide general guidance, and are not intended to be comprehensive nor replace or override any legislative provisions. They should be read in conjunction with the provisions of the relevant legislation, the subsidiary legislation made under the relevant legislation, as well as written directives, and other guidelines that *SEC* may issue from time to time.

1.2 Application and Purpose

1.2.1 These Guidelines on Fitness and Propriety shall apply to:

- (1) Directors of entities licenced and registered under the SEC Act.
- (2) Employees dealing with clients of Investment Managers, Margin Providers, Underwriters, Credit Rating Agencies registered under the SEC Act.
- (3) Registered Investment Advisors of entities licenced as Stock Brokers and Stock Dealers.
- (4) Fund managers of Unit Trust Managing Companies licenced to operate a Unit Trust under the SEC Act.
- (5) Shareholders and/or ultimate beneficiaries, who are capable of exercising significant influence on the management of entities licenced and registered under the SEC Act.
- (6) Members of the senior management including the Chief Executive Officer and the Head of Compliance who is in a position to influence the management of an entity licenced and registered under the SEC Act.

1.2.2 The purpose of the guidelines on fitness and propriety is to set out and describe the criteria that should be considered when :

- (a) assessing the fitness and propriety of a candidate whom a *regulated entity* is proposing to seek approval of SEC in terms of the provisions of the SEC Act;
- (b) assessing the continuing fitness and propriety of a person approved by *SEC*, including for formulating an opinion about whether there are any grounds on which the regulator could withdraw the approval given to that individual to perform that function to which the approval was granted for.

1.3 Role of the Board of Directors

To effectively discharge its responsibilities, the board of directors of a regulated entity shall:

- a) establish policy on fit and proper person , taking into account the criteria stated in these Guidelines;
- b) apply the policy to directors, senior management, shareholders and/or ultimate beneficiaries who are capable of exercising significant influence over the Company and employees dealing with clients;
- c) ensure creation of appropriate documentation on the process implemented and decisions made; and
- d) make the documentation available for inspection by SEC, as and when required.

The Board's further responsibilities are to ensure that:

- a) nominations, initiated by the Board, of persons for election to the board of directors meet the test of fit and proper person set out in these guidelines before such nominations are placed before the shareholders' meeting;
- b) candidates for appointment to the senior management, satisfy the criteria set out in these guidelines before such appointments are made;
- c) acquisition of shares by persons who are likely to be in a position to exercise significant influence on the licensed/registered entity meet the test of fit and proper person before their shares are registered in the register of shareholders;
- d) processes are implemented to keep under constant review the continuing capacity of directors, senior management, shareholders and/or ultimate beneficiaries who are capable of exercising significant influence over the Company and employees dealing with clients.

1.4 Assessing fitness and propriety

The *SEC* will have regard to a number of factors when assessing the fitness and propriety of a person in terms of the *SEC Act* or when assessing the eligibility to continue in such capacity.

The *SEC* would expect the *regulated entities* that are required to assess the fitness and propriety of staff being assessed under these guidelines to have regard to substantially the same factors as those outlined herein.

The *SEC* shall exercise judgment and discretion in assessing fitness and propriety and takes into account all relevant matters including the following in order to ensure that the applicant is capable of sound and prudent management of a regulated institution.

1. Honesty, integrity and reputation
2. Competence and capability; and
3. Financial soundness

The failure by a person to meet any one of the criteria set out herein may not lead to an automatic refusal of an application; revocation of an authorization; revocation of the status of an appointed or other regulatory action by SEC. The significance and relevance of a relevant person failing to satisfy SEC that it or he meets a specific criterion depends on:

- (a) The seriousness of, and surrounding circumstances resulting in, the relevant person not meeting the specific criteria;
- (b) The relevance of the failure by the relevant person to meet the specific criteria to the duties that are performed and the responsibilities assumed by such person; and
- (c) The passage of time since the failure by the relevant person to meet the specific criteria.

Chapter 2

Main assessment criteria

2.1 Honesty, integrity and reputation

Key persons who are honest, diligent, independent-minded, ethical and who act with integrity and fairness are essential to the good reputation and trustworthiness of the securities industry in general and of individual entities in particular.

In determining a *person's* honesty, integrity and reputation, the *SEC* will have regard to all relevant matters including, but not limited to, those set out in these guidelines which may have arisen either in Sri Lanka or elsewhere.

In considering the matters in these guidelines, the *SEC* will look at whether the person's reputation might have an adverse impact upon the regulated entity in the event such person is appointed to such entity.

The matters referred to in these guidelines to which the *SEC* will have regard, and to which a *regulated entity* should also have regard, include, but are not limited to:

(a) whether the person has been convicted of any criminal offence; any conviction by court of law; particular consideration will be given to offences of dishonesty, fraud, financial crime or an offence under legislation relating to companies, banking, other financial services, insolvency, insurance, money laundering, market manipulation and insider dealing, whether or not in Sri Lanka;

(b) whether the person has been the subject of any adverse finding or any settlement in civil proceedings, particularly in connection with investment or other financial business, misconduct, fraud or the formation or management of a body corporate;

(c) whether the person has been the subject of any disciplinary proceedings, by the *SEC*, by other regulatory authorities, including the exchange, professional bodies, or government bodies;

(d) whether the person is or has been the subject of any proceedings of a criminal nature by the *SEC*, by other regulatory authorities, including the exchange, professional bodies, or government bodies;

(e) whether the person has contravened any of the requirements and standards of the regulatory system or the equivalent standards or requirements of other regulatory authorities, clearing houses and exchanges, professional bodies, or government bodies;

(f) whether the person has been the subject of any complaint made relating to regulated activities and found guilty by the *SEC*, by other regulatory authorities, including the exchange, professional bodies, or government bodies;

(g) whether the person has been involved with a company, partnership or other organization that has been refused registration, authorization, membership or a licence to carry out a trade, business or profession, or has had that registration, authorization, membership or licence revoked, withdrawn or terminated, or has been expelled by a regulatory or government body;

(h) whether the person or any business with which the person has been involved, has been cancelled or suspended by SEC, by other regulatory authorities ,including the exchange, professional bodies, or government bodies or a court of law or Tribunal;

(i) whether the person has been dismissed or asked to resign and resigned, from employment or from a position of trust, fiduciary appointment or similar;

(j) whether the person has ever been disqualified from acting as a director or disqualified from acting in any managerial capacity.

2.2 Competence and capability

To demonstrate competence, the person involved in carrying out the securities business must act in a knowledgeable, professional efficient manner and comply with the prevailing regulations. It is the responsibility of the applicant to show that he/she is competent to undertake the activity including, where appropriate, detailed knowledge of the structure, purpose and risks of the products associated with the activity.

In determining a person's competence and capability, the *SEC* shall have regard to matters including, but not limited to:

- (a) the person has satisfactory past performance or expertise in the nature of the business being conducted;
- (b) the person has an appropriate range of skills and experience to understand, operate and manage the regulated activities/financial affairs;
- (c) the person has the technical knowledge and ability to perform prescribed duties for which they are engaged, especially recognized professional qualifications and membership of relevant professional institutions;
- (d) whether the person has ever been diagnosed as being mentally ill or unstable so as to render him unfit to discharge his duties; and
- (e) whether the person has ever been disciplined by a professional, trade or regulatory body, or dismissed or requested to resign from any position or office for negligence, incompetence or mismanagement.

2.3 Financial soundness

In assessing the financial soundness the *SEC* will assess whether the person can maintain solvency and prudent financial control. It includes meeting liabilities as they become due and ensuring adequate control over financial risks on a continuing basis. Financial soundness is an important element in determining the fitness and propriety of applicants.

In determining the financial soundness the *SEC* will consider matters such as, but not limited to:

- (a) Whether there are any indicators that the person will not be able to meet his debts as they fall due;
- (b) whether relevant solvency requirements are met;

(c) whether the person has been or is subject to any judgment debt or award in Sri Lanka or elsewhere, that remains outstanding or has not been satisfied within a reasonable period;

(d) whether the person has made arrangements with its or his creditors, filed for bankruptcy or been declared bankrupt or had assets sequestered;

(e) whether a person who has been a Director of a company or a shareholder in a position to exercise significant influence in the company that:

- a. has been the subject of any adverse judgment or award, in Sri Lanka or elsewhere, that remains outstanding or was not satisfied within a reasonable period; and
- b. has in Sri Lanka or elsewhere, made any arrangements or composition with its creditors, filed for bankruptcy, been declared bankrupt, had assets sequestered, or been involved in proceedings relating to any of the foregoing.

Interpretation

“SEC” mean the Securities and Exchange Commission of Sri Lanka.

“SEC Act” means the Securities and Exchange Commission of Sri Lanka Act No 36 of 1987 amended by Act No 26 of 1991, 18 of 2003 and 47 of 2009.

“Regulated Entities” means all entities licenced /registered in terms of the provisions of the Securities and Exchange Commission of Sri Lanka Act no 36 of 1987 as amended.

“Significant influence” means a person who is in a position to influence directly or indirectly the composition of the board of directors of the regulated entity and /or financial and operating policy decisions of such entity or who holds more than 20% of the shares of the regulated entity.