

Consulting Firm to Develop the Supervision Framework of the Securities and Exchange Commission of Sri Lanka

Terms of Reference for the Consulting firm

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. It is located at 28th /29th floors, East Tower, World Trade Centre, and Colombo 01.

The SEC is the regulatory body entrusted with the regulation and the supervision of market institutions, derivatives stock brokers-dealers, unit trust industry and market intermediaries as defined under the new Securities Exchange Law (referred in this document as 'SEC Bill).

The SEC mission is to promote, develop and maintain a capital market that is fair, efficient, orderly and transparent. Under the World Bank's Financial Sector Modernization Project (FSMP), the SEC stands to gain funding for strengthening of its regulatory and supervisory capacity. It has already been engaged into a broad effort to review and improve how Market Intermediaries are regulated and supervised. To that end, the SEC has made some amendments proposals to the draft SEC Bill, and has draft some implementing regulation¹ with the constant objective to better align with international best practice and standards. The SEC is also seeking to implement a risk-based supervision, with a methodology and process that better reflect its supervisory needs. This is seen crucial for the steady development of the Sri Lankan Capital market.

The SEC is now seeking for technical assistance to complete its project.

The SEC's supervisory approach for Market Intermediaries is based on on-site inspections and off-site supervision. This technical assistance also will include the

¹ With regards to Credit Rating Agencies; Investment Managers; Margin Providers.

training and capacity building to the off-site and on-site Supervision Division which is entrusted with supervision of Market intermediaries.

2. Objective of the assignment

The objective of this project is to provide the SEC with a full technical assistance to review, improve and align the existing regulatory, supervisory and enforcement framework applicable to Market Intermediaries, with reflects international (IOSCO) standards, best practice and the SEC's mission.

3. Scope of work

1) On the Market Intermediaries' regulatory framework

- Identify gaps and deficiencies in relation to the legislation applicable to Market Intermediaries as proposed in the new draft SEC Bill, in particular with regards to international best practices and IOSCO standards. It includes a review of amendments made to the draft Bill according to prior recommendations made to the SEC². It also includes a critical review of the provisions of SEC bill to ensure that all market activities, actors and products are adequately regulated³ and supervised⁴;
- Identify gaps and deficiencies in relation to implementing regulations applicable to credit rating agencies, investment managers and margin providers;
- Identify gaps in the SEC Bill and provide recommendations to the SEC to address these gaps, by way of additional submissions to the law.
- Help in finalizing draft implementing regulations with the SEC on Credit Rating Agencies; Investment Managers and Margin Providers, in accordance to international best practice and IOSCO standards, and taking into consideration the specificities and developmental needs of the Capital market in Sri Lanka;
- Help the SEC to draft implementing regulations for other Market Intermediaries, aligned to international best practices and IOSCO standards and taking into

² As specified in the Country Assessment for Sri Lanka made in August 2020.

³ Including conduct of business rules (such as conflict of interest, best execution other investors' protection rules) as well as prudential rules (initial and on-going capital requirement applicable to Market Intermediaries).

⁴ This includes reporting requirement and eventual legal changes that may be necessary to allow the SEC to adopt a Regulatory Filing system.

consideration the specificities and developmental needs of the Capital market in Sri Lanka.

2) On the Market Intermediaries' supervisory framework

- Determine the adequacy and effectiveness of the existing supervisory programs and processes for Market Intermediaries. Identify gaps, deficiencies and improvements needed to implement a more effective risk-based supervision;
- Make recommendations and concrete proposals to address all identified gaps and deficiencies with a detailed action plan for the SEC to follow and implement with the help of the consulting firm.
- Provide the SEC with on-site and off-site supervisory manual, workflows and internal process;
- Help the SEC in drafting their annual supervisory plan based on the new Risk based methodology;
- Review make all necessary recommendations and assist the SEC in implementing a reporting framework. This includes identifying the content, format and periodicity of Market Intermediaries' reporting to the SEC, defining the functional and technical reporting requirements to be adopted in a Regulatory Filing system and developing the related Systems' Requirement Specification (SRS)⁵.

3) Enforcement framework

- Identify gaps and deficiencies in relation to the enforcement Framework of Market Intermediaries rules;
- Provide recommendations to achieve an efficient and credible and the enforcement framework aligned to IOSCO standards and taking into consideration the specificities and developmental needs of the Capital market in Sri Lanka;
- Help the SEC to draft appropriate enforcement rules.

⁵ In order to do so the Consulting firm will liaise with IT Strategy Consultant on the procurement and implementation of a suitable Regulatory Filing system, as necessary.

4) Capacity building

- Hold the necessary workshops and training sessions (periodicity and content to be agreed with SEC staff) with local Market Intermediaries on the regulation on conduct and prudential requirements, the reporting requirements and the improved Risk based supervisory, and the new enforcement framework;
- Held (at least 6) workshops and training sessions to SEC Staff on the Market Intermediaries new regulatory framework (rules of conduct and prudential requirements) – the format, the content and the periodicity are to be agreed with SEC staff;
- Held (at least 10) workshops and training sessions to SEC staff on the new Market Intermediaries supervisory framework, including reporting systems – The format, the content and the periodicity are be agreed with SEC staff;
- Held (at least 4) workshops and training sessions to SEC staff on the new enforcement framework– The format, the content and the periodicity are be agreed with SEC staff.

4. Deliverables

Deliverable	Description	Proposed Time- Line
Inception Report	For discussion with the SEC: A presentation by the consulting firm of its understanding of the regulatory, supervisory, enforcement and business environment of the markets and Market Intermediaries' in Sri Lanka; Potential area of improvements; explanations on the methodology to be used by the Consulting firm; Action & meetings envisaged, timelines for each deliverable, envisaged capacity building, actions, etc.	Within 1 Month
Regulatory framework		
Deliverable RF1	<p>Regulatory Audit Report</p> <ul style="list-style-type: none"> - Identifying gaps and deficiencies in relation to the existing legislation applicable to Market Intermediaries as proposed in the new SEC Bill, including: - a review of amendments made to the SEC Bill with respects to prior recommendations already made to the SEC in the context of aligning with IOSCO standards; - a critical review of the existing SEC bill provisions to ensure that all market activities will be adequately regulated and supervised. - Identifying gaps and deficiencies in relation to the regulation applicable to credit rating agencies, investment managers and margin providers; - Identifying remaining implementing regulation to put in place with respect to other market intermediaries; - Provide <u>recommendations</u> to the SEC in order to: <ul style="list-style-type: none"> - Strengthen the SEC Bill, - Strengthen the implementing regulations on Credit Rating Agencies; Investment Managers and Margin Providers, and, - List the implementing regulation for other Market Intermediaries (namely Corporate Finance Advisor, Derivatives Broker, Derivative Dealer, Financial Planner, Investment Analyst, Market Maker, Placement Agent, Stockbroker, Stock Dealer, Underwriter) and any other market intermediaries and Supplementary Service provider as 	Within 2 months


	<p>recommended by the Consultant, to be adopted and the main features of these rules.</p> <p>The recommendations will be aligned to international best practices and IOSCO standards and take into consideration the specificities and developmental needs of the Capital market in Sri Lanka, as well as the need for developing an effective supervisory framework of Market Intermediaries in Sri Lanka.</p>	
Deliverable RF2	<ol style="list-style-type: none"> 1. Provide <u>drafting proposals</u> to strengthen gaps in SEC Bill, and, 2. Provide <u>drafting proposals</u> on the implementing regulations for Credit Rating Agencies; Investment Managers and Margin Providers. 	Within 4 months
Deliverable RF3	<ol style="list-style-type: none"> 1. Provide <u>drafting proposals</u> the implementing regulation for other market intermediaries as described in FR 1, to be adopted by the SEC. 	Within 6 months
Deliverable RF4	<p>Final regulatory framework report</p> <ol style="list-style-type: none"> 1. Provide <u>final drafting proposals</u> (based on consultation and discussions with the authorities) on the implementing regulations for <u>all</u> market intermediaries, to be adopted by the SEC. 	Within 9 months
Supervisory Framework		
Deliverable SF1	<p>Supervisory Auditing Report</p> <ol style="list-style-type: none"> 1. Determining the adequacy and effectiveness of the existing supervisory processes and the program applicable to Market Intermediaries; 2. Identifying gaps, deficiencies and improvement needed for the SEC to implement more effective a risk-based supervision; 1. Provide <u>Recommendations</u> to address all identified gaps and deficiencies, with an action plan. 2. List, describe the main features, the content and the periodicity of Market Intermediaries' reporting to the SEC; 	Within 2 months
Deliverable SF2	<p>Reporting report</p> <ol style="list-style-type: none"> 1. Provided a draft of all standardized reporting to fit the RFS 2. Make proposal for the functional and technical reporting requirements to be implemented in the Regulatory Filing system (RFS); Develop related Systems' Requirement Specification (SRS). 	Within 6 Months

<p>Deliverable SF3</p>	<p>Risk Based Supervision Methodology</p> <p>Develop a Risk based Supervisory methodology that will allow effective Off and On-site supervision of conduct rules and prudential (capital adequacy rules) requirements applicable to Market Intermediaries.</p> <p>For the Off-site conduct and prudential (capital adequacy rules) supervision, the Methodology should include:</p> <ul style="list-style-type: none"> - Recommendations on the organisational needs to optimize the allocation of SEC resources, and on internal information flow and cross linkages with other SEC teams; - Guidelines on the Offsite management of Information and reporting to SEC; - A risk scoring methodology at micro and macro level, including an identification of relevant business model and market products risk, risk indicators, mitigating factors, Early warnings measures and a risk scoring dashboard for real time following Market Intermediaries activities and products; - Guidelines for risk monitoring process. <p>For the On-site supervision of conduct and prudential (capital adequacy) rules, the methodology should include an inspection manual that contains at least guidelines on all preparatory work to be done prior to an inspection, assessment work and criteria of conduct, prudential and financial issues, as well as inspections follow-up work (with standardized Inspection reports ...).</p> <p>This Risk based approach supervisory framework will be aligned with IOSCO online toolkit for Risk based Supervision.</p> <p>The consulting firm will help the SEC to elaborate its next annual supervisory plan based on the new Risk based supervision methodology.</p>	<p>Within 11 Month</p>
<p>Enforcement framework</p>		
<p>Deliverable EF1</p>	<p>Enforcement auditing report</p> <ul style="list-style-type: none"> - Identify gaps and deficiencies in relation to the enforcement Framework applicable to Market Intermediaries; - Provide recommendations to achieve an efficient and credible and the enforcement framework with regards to IOSCO standards and taking into consideration the specificities and developmental needs of the Capital market in Sri Lanka; 	<p>Within 2 months</p>
<p>Deliverable EF2</p>	<p>Final Enforcement framework report</p> <p>Provide <u>drafting proposals</u> on enforcement rules for market intermediaries activities.</p>	<p>Within 9 months</p>

Capacity building actions		
CB1	Delivery of Training, workshop on all Deliverables	Ongoing – periodicity, format and content to be agreed with SEC.
Final Report		
FR1	Final Report covering all Deliverables (comprising the final regulatory and enforcement reports as well as the complete Risk Based Supervision methodology and annual supervisory plan).	within 12 months / End of the Contract

The assignment will be carried out by the consulting firm for a total period of 12 month.

A review committee will be appointed to evaluate the outputs of the assignment. The committee will review and provide feedback on each deliverable. The payments will be made upon the acceptance of the deliverables by the review committee.

Deliverables	Monthly Time horizon											
	1	2	3	4	5	6	7	8	9	10	11	12
Inception Report	█											
RF 1 - Regulatory Audit Report	█	█										
RF 2- Drafting proposals (1)	█	█	█	█								
RF 3 - Drafting proposals (2)	█	█	█	█	█	█						
RF 4 - Final regulatory framework report	█	█	█	█	█	█	█	█	█			
SF1 - Supervisory Auditing Report	█	█										
SF2 - Reporting report	█	█	█	█	█	█						
SF3 - Risk Based Supervision Methodology	█	█	█	█	█	█	█	█	█	█	█	
EF1 - Enforcement auditing report	█	█										
EF2 - Final Enforcement framework report	█	█	█	█	█	█	█	█	█			
CB1 - Capacity building actions	█ 											
FR1 - Final Report												█

6. Information and assistance to be provided by the SEC

- Existing Supervision Manuals;
- Existing document management system for Market Intermediaries (specifically in relation to Stockbrokers);
- Existing Securities and Exchange Commission of Sri Lanka Act and proposed Securities Exchange Bill;

A divisional member/s will be assigned as a resource person and be the main contact point of the Consulting firm at the SEC. Basic logistical support such as the organizing meetings at the SEC and facilitating meetings with key counterparts, will be provided by this person. All other inputs required to carry out the assignment will be the responsibility of the selected consultant.

7. Team Composition & Key Expertise

Team Leader

- Relevant academic and professional qualifications including a master's or higher degree in a related field (economics, finance, law);
- At least 20 years of cumulative professional experience in capital markets ;
- Sound knowledge of international best practices and IOSCO principles, with at least 10 years of professional and senior management experience in the area of financial market regulation and supervision with the reputable capital market regulator from an IOSCO member country;
- At least 10 years of relevant consultancy work on the capital market regulatory and supervisory reforms and approximation with international standards, including IOSCO principles;
- Proven leadership skills, successful experience and impeccable reputation (evidence and references provided) in leading the team of experts for at least three comparable (in scope and complexity) international consultancy assignments for development of capital market regulatory and supervisory framework around the globe and specifically in countries with similar development challenges as Sri Lanka.

Key Experts on Market Intermediaries' regulation and enforcement

Competencies

- Relevant academic and professional qualifications, including a master's or higher degree in a related field (economics, finance, law);
- Minimum 10 years of experience in capital market regulation and supervision, specifically in the area of intermediaries' market conduct and prudential regulation, enforcement framework, preferably with the market regulator of an IOSCO member country;
- Sound knowledge and at least 5 years of professional experience in developing a framework for conduct and prudential requirements, developing an enforcement framework, for all market activities and products covered under the present assignment;
- At least 3 years of international consulting experience and impeccable reputation in implementing compatible consulting assignments for development of capital market regulation and supervision (in terms of scope and complexity) around the globe and the markets with similar market development challenges as Sri Lanka

Key Experts on Market Intermediaries' supervision

Competencies

- Relevant academic and professional qualifications, including a master's or higher degree in a related field (economics, finance, law);
- Minimum 10 years of experience in capital market intermediaries' supervision of conduct and prudential rules, preferably in a managerial position at the market regulator of an IOSCO member country;
- Sound knowledge and at least 7 years of experience in data analysis, risk management process, governance and conduct rules of market intermediaries;

- At least 5 years of experience in developing and implementing a risk based supervisory framework impeccable reputation and at least 3 years of experience in implementing similar consultancy assignments around the globe and markets with similar development challenges as Sri Lanka.

All team members will:

- Be reputed professionals with no conflict of interest, no criminal convictions or records;
- Display adequate sensitivity to, and cultural understanding of, the environment into which the assignment is operating;
- Have strong communications and good interpersonal and presentational skills supported by a strong ethical basis;
- Be fluent in English (both speaking and writing skills).

The assignment will be carried out by the consulting firm for a total period of 12 month.

7. Confidentiality

All materials produced or acquired by the consultant under this assignment not already in the public domain shall be treated strictly confidential and shall only be used in connection with the execution of these terms of reference. All intellectual property rights arising from the execution of these terms of reference are assigned to the SEC. The content of part or all written materials obtained and used in this assignment may not be disclosed to any third parties without the expressed and advance written authorization of the SEC.
