FINAL REPORT

CAPITAL MARKET MASTER PLAN SRI LANKA

1 August 2006

Securities and Exchange Commission
of Sri Lanka

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Acronyms and Abbreviations

ABS	Asset Backed Securities
ADB	Asian Development Bank
ADR	American Depository Receipt
ASPI	All Share Price Index
CBSL	Central Bank of Sri Lanka
CDA	Central Depository Agent
CDS	Central Depository System
CMP	Capital Market Masterplan
CSE	Colombo Stock Exchange
EPF	Employees Provident Fund
EPU	Economic Planning Unit
ESOS	Employees' Share Option Scheme
ETF	Employees' Trust Fund
FELDA	Federal Land Development Authority
FIBV	Federation Internationale des Bourses de Valeurs (or International Federation of Stock Exchanges)
GDP	Gross Domestic Product
GDR	Global Depository Receipt
GLC	Government-Linked Company
LFX	Labuan International Financial Exchange
ICULS	Irredeemable Convertible Unsecured Loan Stock
IPC	Infrastructure Project Company
MSCI	Morgan Stanley Capital Index
MOU	Memorandum of Understanding
MSW	Minority Shareholders Watchdog
NEAC	National Economic Action Council
NEC	National Equity Corporation
PMO	Programme Management Office
PNB	Permodalan Nasional Berhad
REIT	Real Estate Investment Trust

SEC	Securities and Exchange Commission
SEMA	Strategic Enterprise Management Authority
SOE	State-Owned Enterprise

Section 1.0 Introduction

1.1 Background

This Capital Market Master Plan (Master Plan) charts the future direction of the Sri Lankan capital market for the next 10 years from 2006 through 2015. This Master Plan aims to enhance the development and performance of the Sri Lankan capital market by providing clarity of the vision and objectives to the capital market stakeholders as well as recommendations to be implemented to move forward. It is also intended to ensure that the capital market is well-positioned to support Sri Lanka's economic development and wealth creation among the urban and rural populace.

The Asian Development Bank (ADB) appointed Ernst & Young Malaysia to assist the Securities and Exchange Commission of Sri Lanka (Sri Lanka SEC) to develop the Master Plan.

1.2 Approach and Consultation Process

Ernst & Young adopted a three-phased approach to develop this Master Plan:

Phase 1: Assessed Current State	Phase 2: Developed Hypothesis	Phase 3: Formulated Strategic Recommendations
• Conducted secondary desktop research to obtain benchmark data. • Collated information provided by Sri Lanka SEC. • Reviewed regional trends and challenges. • Interviewed Sri Lanka's capital market stakeholders.	• Analysed findings from research and interviews. • Developed hypothesis. • Confirmed vision of Sri Lanka's capital market. • Developed preliminary: - Objectives. - Recommendations. - Implementation framework.	• Conducted Strategy Workshop with representatives from Sri Lanka SEC. • Obtained feedback from Sri Lanka SEC and industry stakeholders on the: - Vision statement. - Objectives. - Recommendations. - Implementation framework.

In developing the Capital Market Master Plan, a series of consultations with relevant Government Ministries and capital market stakeholders were held. The finding of various studies / reports on the capital market were also reviewed and considered. The collective input, combined with the Sri Lanka SEC's own internal work and research formed the basis for the development of the Master Plan. Specifically, consultations were held with:

Government	Associations	Organisations
• Central Bank of Sri Lanka (CBSL). • Employees' Provident Fund (EPF). • Employees' Trust Fund (ETF). • Minister of Public Enterprise Reform. • Ministry of Finance and Planning. • Sri Lanka SEC. • Insurance Board of Sri Lanka.	• Association of Primary Dealers. • Ceylon Chambers of Commerce. • Institute of Chartered Accountants. • Stock Brokers Association. • Unit Trust Association.	• Colombo Stock Exchange (CSE). • Credit Rating Agencies; i.e. RAM and Fitch. • Debt Market Specialist. • Ernst & Young Sri Lanka. • Fund Managers. • Foreign Banks i.e. Deutsche Bank and HSBC Bank. • Large Corporates (Dialog Telecom Ltd, John Keells Holding Ltd, Brandix Lanka Ltd).

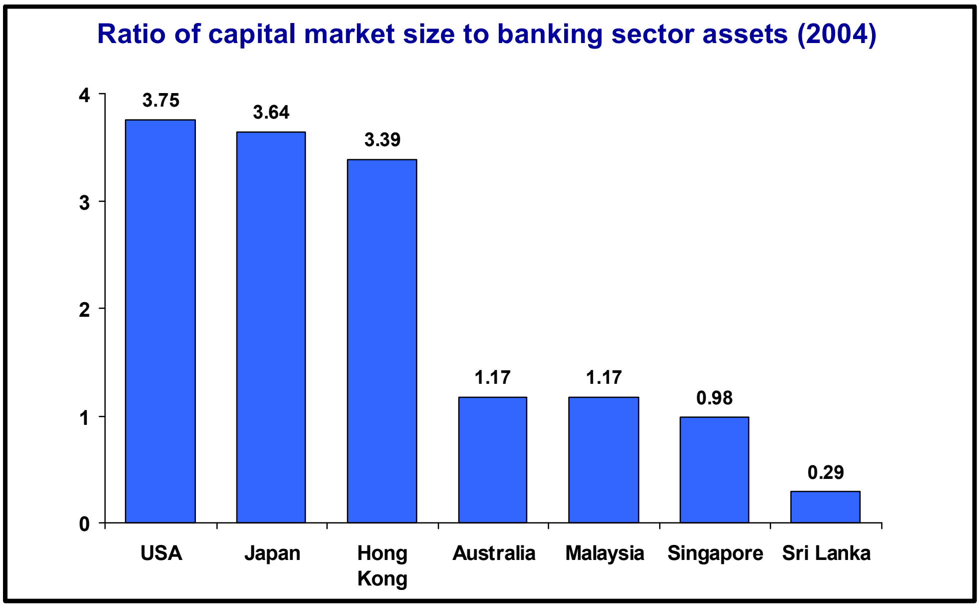
Some of the key documents reviewed include:

- Sri Lanka SEC Corporate Plan.
- Sri Lanka SEC Annual Report 2004.
- Central Bank of Sri Lanka, Annual Report 2005.
- Central Bank of Sri Lanka, Financial Stability Review 2005.
- Financial Sector Master Plan, Central Bank of Sri Lanka.
- CSE Report on the Feasibility of Introducing Equity Derivatives.
- CSE Fact Book 2005.
- CSE's Strategic Direction Report.
- Report on the Development of the Listed Debt Market in Sri Lanka.
- Securitisation Study, ADB.

Section 2.0 Importance of the Capital Market to Sri Lanka

Sri Lanka is heavily dependent on the banking sector to fund its economic development. This raises the possible risk of financial contagion as experienced in other Asian countries during the 1997 Financial Crisis. Figure 1 highlights that the ratio of the capital market size to banking sector assets in Sri Lanka is only 0.29 in 2004. Benchmark studies with other economies have shown greater reliance on capital market as a key source of fund raising.

Figure 1: Ratio of capital market size to banking sector assets (2004)



Sources: Respective Central Banks, Bank for International Settlements, Federation Internationale des Bourses de Valeurs (International Federation of Stock Exchanges), ADB, Federal Deposit Insurance Corporation – Statistic Profile on United States Banking Industry, International Market Research Website and Ernst & Young Research and Analysis.

Since the capital market provides an alternative source of funding to complement the banking sector, the growth of the capital market is vital for the economic development of Sri Lanka. However, the capital market is not to compete against the banking sector, but to complement as a viable alternative source of funding.

The capital market provides several advantages as a source of funding / investment:

- Provides a platform for matching of assets-liabilities maturity portfolio where longer term projects require longer term funding and vice-versa.
- Facilitates greater dispersion of risks.
- Reduces cost of funding through adoption of value maximising capital structures.
- Provides varied instruments to match investors' risk appetite.
- Reduces the risk of a liquidity crunch as a result of over-dependence on the banking sector as shown in the Asian experience during 1997 Financial Crisis.

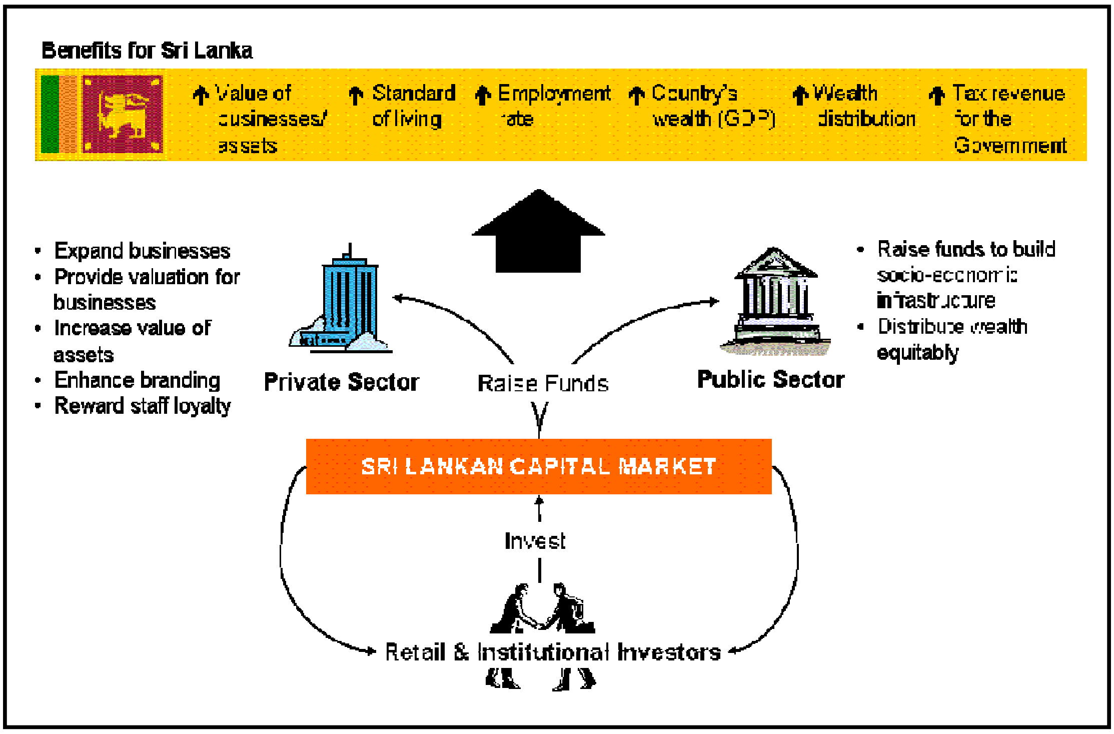
Further, companies can use the capital market for purposes beyond raising funds. Amongst others, for:

- **Branding and market positioning** – listed companies are perceived to adopt stronger corporate governance and have higher level of trust with the banks, customers, regulators etc.;
- **Valuation and exit strategy –** through listing, companies are able to obtain better pricing on their businesses and assets for shareholders. In addition, this also serves as a platform for exit by the third or later generations of the shareholders;
- Bringing in **professional management** to further enhance the value of the company; and
- **Rewarding staff loyalty** through Employees Share Option Scheme (ESOS).

As illustrated in Figure 2, the country will also benefit as a result of the growth in the capital market. Some of the potential benefits of a vibrant capital market to Sri Lanka include:

- Increased value of businesses / assets of the country.
- Improved standard of living for Sri Lankans.
- Higher employment rate.
- Increased in the country's wealth in terms of Gross Domestic Product (GDP).
- Better wealth distribution, especially to the rural populace.
- Higher tax revenue for the Government.

Figure 2: Benefits of the Capital Market to Sri Lanka



Therefore, the development of the capital market is vital for the economic growth of Sri Lanka.

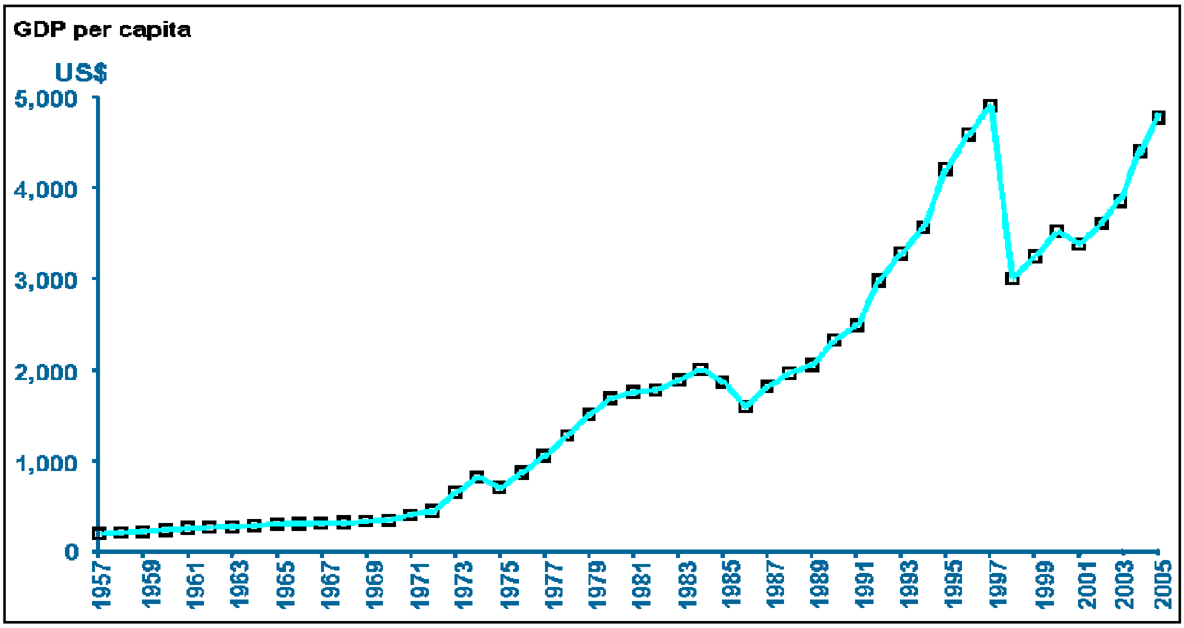
Section 3.0 The Malaysian Experience

3.1 Historical Development

The Malaysian economy has developed significantly since gaining independence in 1957. GDP per capita grew 24 times, from US$200 in 1957 to US$4,800 in 2005 (as shown in Figure 4). Poverty level in Malaysia dropped from 51% in 1970 to less than 3% in 2005[1].

Since Independence, the economy has undergone profound structural changes. In 1957, agriculture, forestry and fishing were the major sectors up to the 1980s. Subsequently, the manufacturing sector played a more dominant role. Moving forward, the Malaysian Government's push is for a "knowledge-based economy", focusing on services sector, information technology and bio-technology.

Figure 3: Malaysia's GDP Per Capita (1957 - 2005)

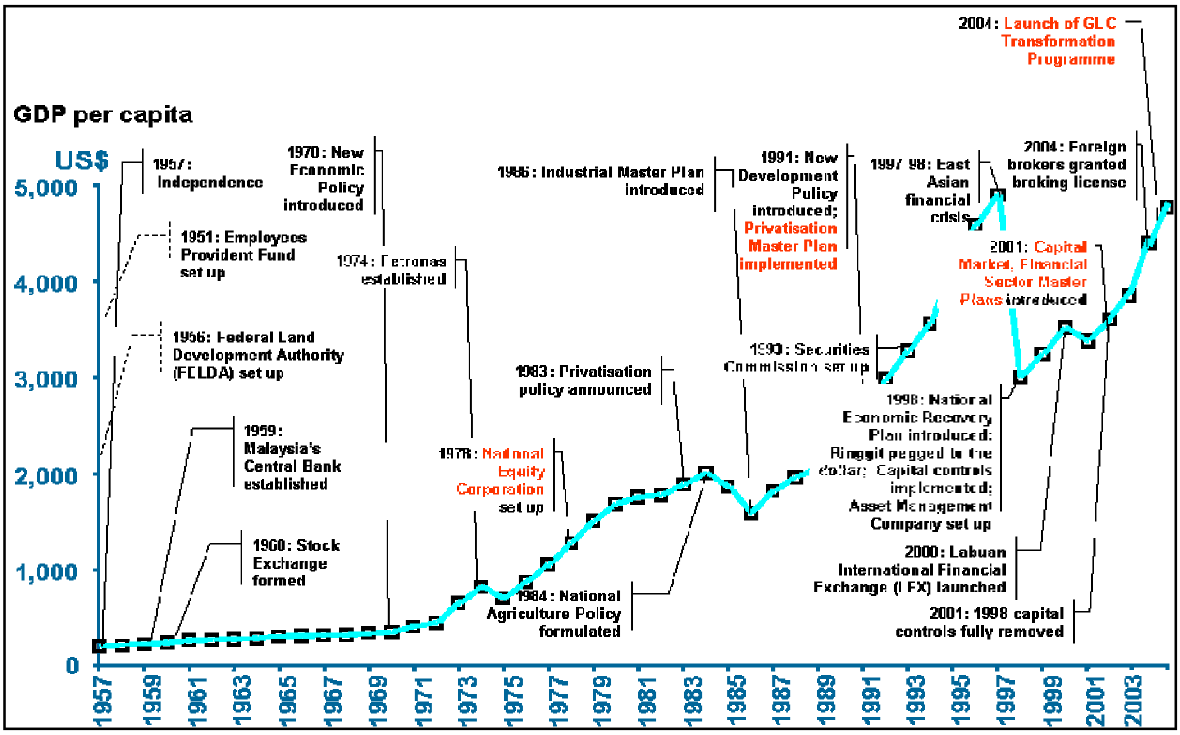


Sources: Ernst & Young Analysis

[1] Securities Commission of Malaysia, Ernst & Young Research and Analysis.

As a result of the Malaysian Government's long term planning and establishment of various key institutions, there were significant economic developments since Independence. This is illustrated in Figure 4.

Figure 4: Development of the Malaysian Economy (1957 - 2005)



Sources: Ernst & Young Analysis

3.2 Key Success Factors

The success of the Malaysian economy can be attributed to three (3) key factors:

3.2.1 Stable Political Climate

The political stability is mainly due to the presence of a strong ruling coalition, comprising of political parties from various ethnicity. This strong coalition has enabled the Malaysian Government to effectively plan the development of the country.

3.2.2 Effective Planning and Implementation

The Government of Malaysia places significant importance in long-term planning and implementation in charting the development of the economy. Some of the key national policies/plans developed and implemented since Independence include:

- Industrial Master Plans.
- Outline Perspective Plans.
- Five-Year Malaysia Plans
- “Malaysia Incorporated”.
- Privatisation Master Plan.
- National Economic Recovery Plan.
- Capital Market Master Plan (CMP).
- Financial Sector Master Plan.
- National Agriculture Policy.
- Government-Linked Companies (GLC) Transformation Programme.

3.2.2.1 Malaysia Incorporated

The Malaysian Government introduced the “Malaysia Incorporated” policy to promote the private sector as the main engine of growth. Various schemes were used to support the policy including:

- Outsourcing.
- Concession for new infrastructure projects.
- Equitisation.

The policy has successfully reduced the administrative and financial burden of the Malaysian Government as depicted in Figure 5.

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Figure 5: Benefits of “Malaysia Incorporated”

Item	1983 – 2005
Proceeds (USD million)	
Sale of assets	426.8
Sale of equity	1,372.3
Savings (USD million)	
Capital expenditure	42,766.9
Operating expenditure	2,151.9
Number of public sector employees transferred to private sector	113,220

Equity Ownership	2005 Par value	
	USD Million	% of Total
Government	2,503.8	31.2
Bumiputera	4,139.3	51.7
Non-Bumiputera	714.7	8.9
Foreign	657.9	8.2
Total	**8,015.8**	**100.0**

Sources: Ernst & Young Research and Analysis

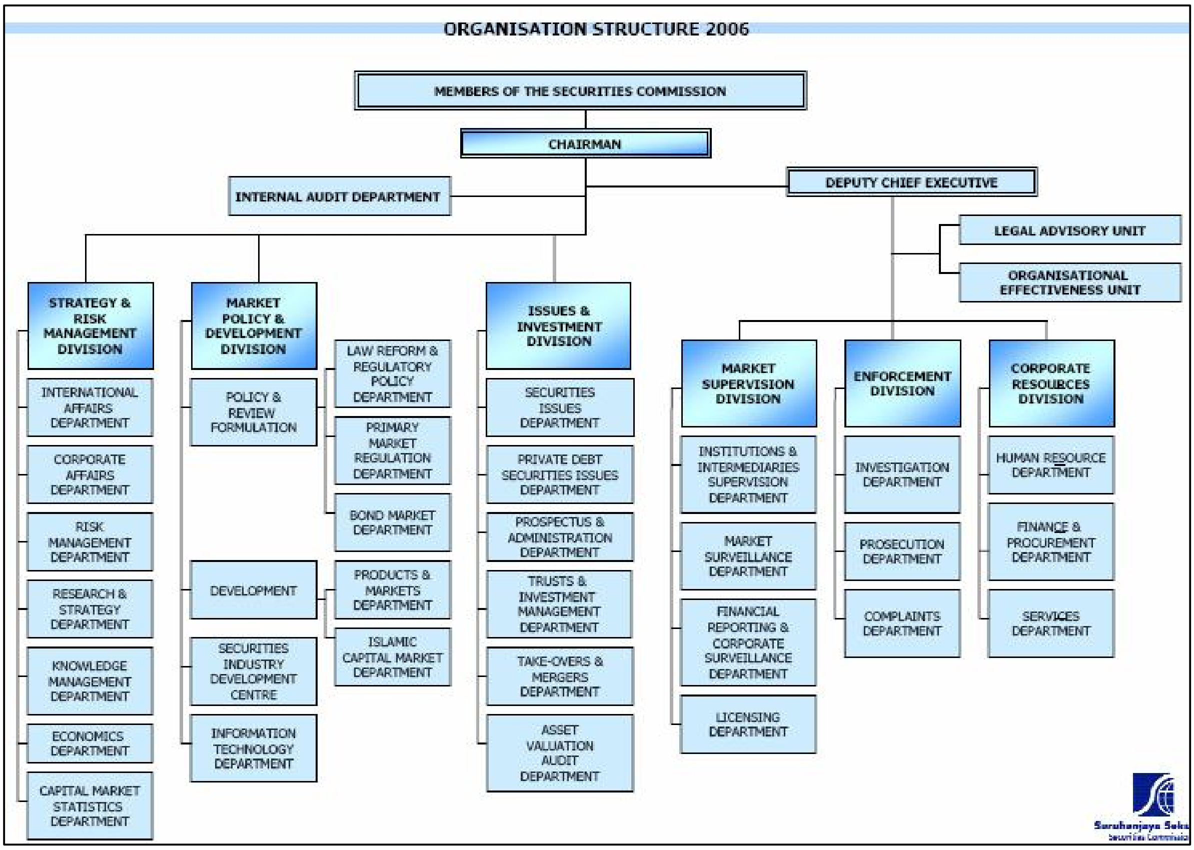
As shown above, in implementing the "Malaysia Incorporated" policy, the Malaysian Government continued to maintain 31% equity interest especially in investments of national strategic importance.

3.2.2.2 Capital Market Master Plan (CMP)

The development of the CMP in 2001 has played a pivotal role in the strategic development of the Malaysian capital market. In total, there were 152 recommendations covering 11 areas including market institutions, equity market, bond market, investment management etc.

To support the effective implementation of the CMP, the Securities Commission of Malaysia was beefed up with the recruitment of additional human capital especially in the area of market development (refer Figure 6).

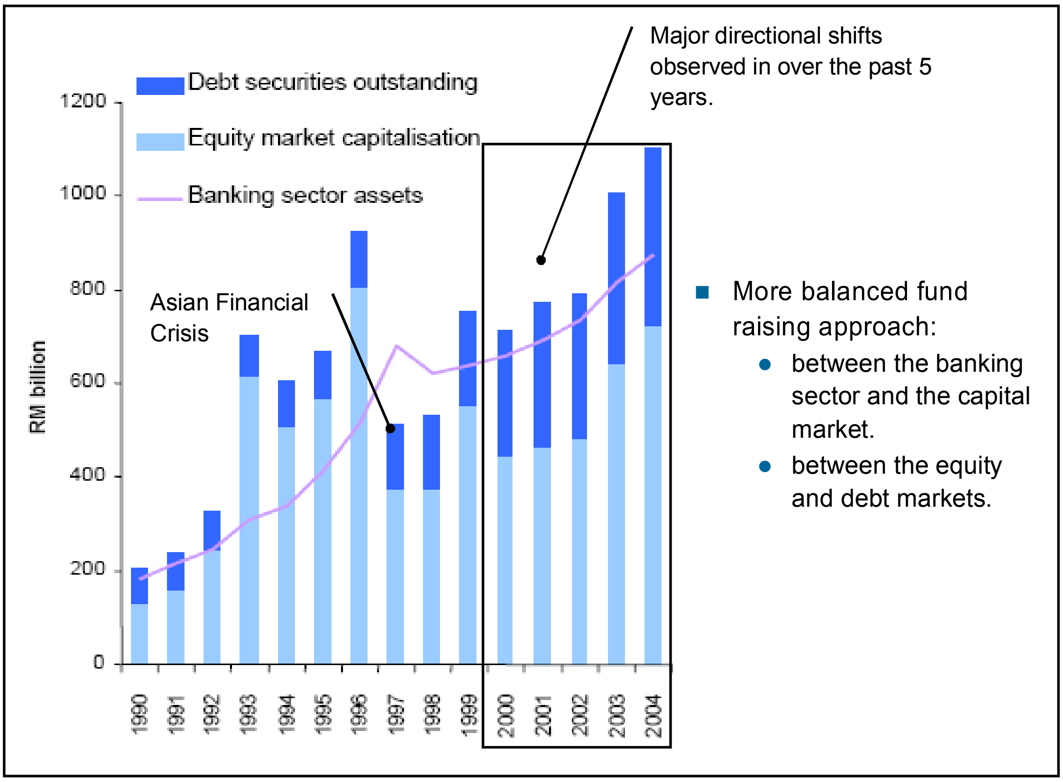
Figure 6: Organisation Structure of the Securities Commission of Malaysia



Source: Securities Commission of Malaysia

As a result of the effective implantation of the CMP, there has been a major directional shift in the fund raising approach between the banking sector and the capital market. Secondly, there was also a significant shift from equity to debt instruments. This trend is depicted in Figure 7.

Figure 7: Sources of Funding for the Malaysian Economy (1990 - 2004)



Sources: Securities Commission of Malaysia, Ernst & Young Analysis

3.2.2.3 Government-Linked Companies (GLC) Transformation Programme

The GLC Transformation Programme introduced by the Malaysian Government in 2004 was aimed at transforming Malaysian GLCs into high performing entities to achieve the aspirations of Vision 2020, which is to become a developed nation. Ten initiatives were recommended in the programme to drive and enhance GLC performance. They include:

- Enhance Board effectiveness.
- Strengthen Directors' capabilities.
- Enhance management and monitoring functions.
- Improve regulatory environment.
- Clarify social obligations.
- Review and revamp procurement.

- Optimise capital management practices.
- Manage and develop leaders and other human capital.
- Intensify performance management practices.
- Enhance operational improvement.

3.2.3 Establishment of Key Institutions

The Government of Malaysia also established certain institutions that were fundamental in developing Malaysia. Some of the key institutions include:

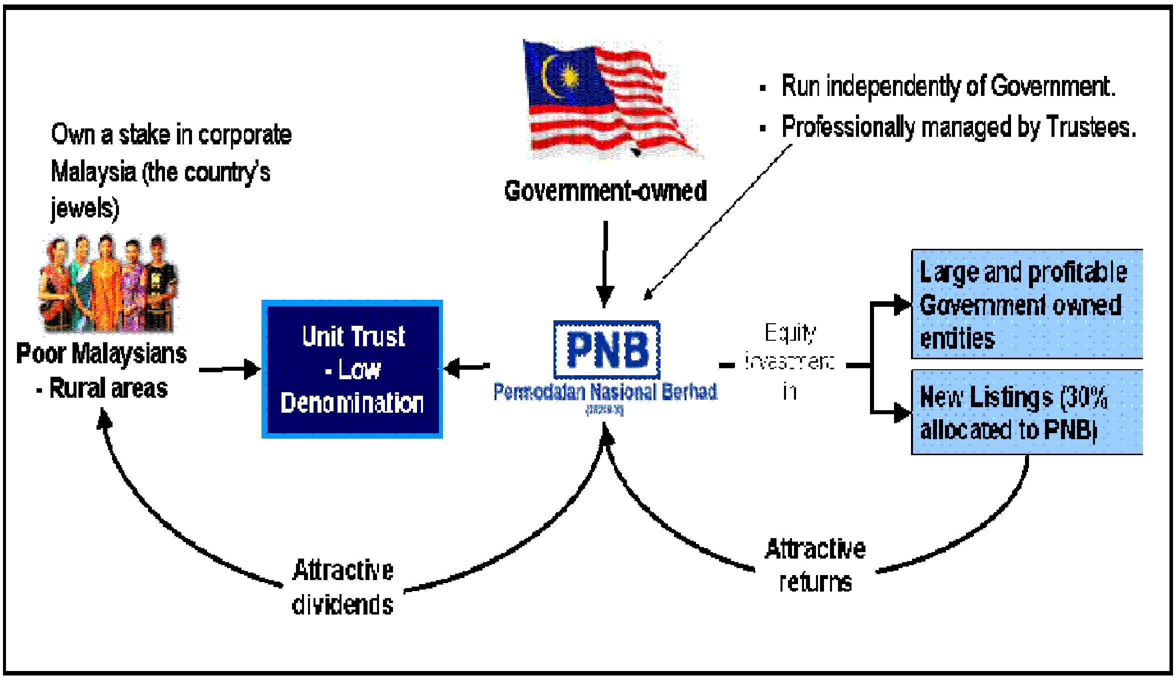
- Bursa Malaysia (formerly the Kuala Lumpur Stock Exchange).
- Central Bank of Malaysia.
- Economic Planning Unit (EPU).
- Employees' Provident Fund (EPF).
- Federal Land Development Authority (FELDA).
- National Economic Action Council (NEAC).
- National Equity Corporation or otherwise known as Perbadanan Nasional Berhad (PNB).

3.2.3.1 Permodalan Nasional Berhad (PNB)

PNB has been successful in enabling rural and poor Malaysians to participate in the capital market since its establishment in 1978. It has also been successful in cultivating widespread savings habits and wealth creation among the populace.

Figure 8 below depicts the PNB model.

Figure 8: National Equity Corporation Model



Source: Ernst & Young Research and Analysis

Malaysia's PNB success is mainly due to the attractive returns it offers as well as the coordinated, disciplined and persistent marketing and public relations, especially at the start. For example, recently, an issue of USD300 million unit trusts, they were all sold within 1 hour and 40 minutes.

Section 4.0 Current State Assessment

This section provides an overview of the strengths, challenges and opportunities for the Sri Lankan capital market.

4.1 Strengths of the Sri Lankan Capital Market

The Sri Lankan capital market can be summed up in one phrase – "a jewel in the crown". From the various interviews and discussions carried out during the project, this "jewel" has significant potential to contribute to the development of the Sri Lankan economy. However, some "polishing" will be required to maximise its potential. Unlike other jurisdictions, the Sri Lankan capital market is unencumbered with serious legacy issues. This enables the Sri Lankan capital market an easier route to move forward towards its shared vision described later in this Master Plan.

The trading infrastructure and regulatory framework are largely in place to facilitate trading of securities. The trading infrastructure has not experienced any failure since inception. Similarly, the stockbrokers are also reasonably resilient and the market has yet to see any significant failures or collapses.

On the issuers' side, Dialog Telekom Ltd's listing recently was a good success story to increase investors' confidence in the Sri Lanka's capital market. The offering was oversubscribed 12 times by foreign investors, indicating keen interest by foreign parties.

4.2 Significant Opportunities for Growth

Despite the social unrest, the Sri Lanka has managed to sustain a GDP growth of between 5-6%. Should peace prevail, the GDP growth would be potentially higher. Also, Sri Lanka's close proximity and similarities with the growing Indian sub-continent (e.g. India, Pakistan, Maldives and Seychelles) create the opportunity for the Sri Lankan capital market to be the preferred provider of selected financial services to these growing economies.

The issuers' side offers significant growth opportunities too. The listing of State-Owned Enterprises (SOEs) will enable the Sri Lankan government to convert its liabilities into assets. There are also a sizeable number of large family-owned corporations that have yet to tap the capital market for funding purposes.

Insurance companies may also be required to be listed should the proposed amendment to the Insurance Act be passed, which should provide further depth to the capital market.

4.3 Challenges Faced

There are substantial challenges that need to be addressed such as the changing political environment. Uncertainty in the peace process can erode faith in the capital market, especially with the foreign investors.

The banking sector disproportionately dominates and is the primary source of funding for corporations in Sri Lanka. This is primarily due to a lack of understanding and awareness of the capital market's products and services. Family-owned corporations need to be educated and incentivised to tap into the capital market.

EPF and ETF capture a significant portion of the nation's savings. However, these funds are invested mainly in Treasury Bills rather than capital market instruments. Secondly, the management of funds is done in-house. This is one of the factors that have hampered the growth of the fund management industry.

Sri Lanka SEC is also limited by the capacity of its staff force. The current focus is on regulatory and surveillance role. There is an urgent need to build up its "nurturing" role as more hand-holding is required at this stage of its capital market development.

Sri Lanka SEC and market participants are aware of what needs to be implemented to build up the capital market. However, implementation has fallen short in the past. This has led to skeptism and frustration. Therefore, buy-in and the political will to push forward this Master Plan will be required to capitalise on the strengths and opportunities.

Lastly, an aggressive education programme needs to be carried out fairly quickly to raise awareness of the potential benefits and investment opportunities in the capital market.

For detailed assessment of the strengths, opportunities and challenges, please refer to Appendix B.

Section 5.0 Vision of the Sri Lankan Capital Market

The shared vision of the Sri Lankan capital market was developed based on the feedback from its key stakeholders. These stakeholders, from both the private and public sectors, have many common grounds of where they view the future of the Sri Lankan capital market. This shared vision is supported by 4 vision elements, 4 objectives and 44 recommendations to be implemented over 4 phases.

1 Shared Vision

4 Vision Elements

4 Objectives

44 Recommendations

4 Phases

5.1 Vision Elements

By 2015, the Sri Lankan capital market will be:

- An engine of growth to facilitate the economic development of Sri Lanka.
- A viable alternative source of funds/investment.
- A liquid and vibrant market.
- Regionally positioned for the South Asian region.

The four vision elements are elaborated below:

5.1.1 Engine of Growth to Facilitate Economic Development of Sri Lanka

The Sri Lankan capital market will play a pivotal role in enabling SOEs to raise funds, either through equity or debt, for building socio-economic infrastructure to improve the standard of living in the country, especially outside Colombo.

In addition, public-listed companies will also raise most of their capital through equity and private debt securities. They will also be a significant employer of talent, paying competitive salaries to attract top talent.

5.1.2 Viable Alternative Source of Funds / Investment

The Sri Lankan capital market will be an alternative source of funding to large local and foreign corporations and SOEs. It will provide the flexibility in terms of duration / tenure and cheaper cost of funding compared to the banking sector. It will also offer investors a broad range of capital market products catering to various risk-return profiles including derivates and collective investment.

5.1.3 Liquid and Vibrant Market

The Sri Lankan capital market will be the preferred choice for Sri Lankan companies to raise funds. It will bear the hallmarks of an efficient and effective capital market with liquidity and vibrancy, spurring secondary market activity, resulting in:

- Enhanced trading infrastructure.
- Greater participation by EPF and Employees' Trust Fund (ETF) into the capital market.
- Greater participation by domestic (including rural populous) and foreign investors.

A vibrant market is measured by the depth and breadth of the capital market where there will be:

- More issuers (both large corporations and SOEs) to list or raise corporate bonds.
- More participants attracted (local and foreign investors) to invest in the Sri Lankan capital market.
- Wider range of capital market products and services to meet different risk appetites.

5.1.4 Regional Positioning for the South Asian region

Sri Lankan capital market will be the preferred provider of selected financial services to serve the growing needs of the South Asian region (Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka). It will not compete, but complement countries in the region where it will be a niche provider of selected financial services.

It will also be positioned as a niche for foreign investors in selected sectors of the capital market, providing ease of entry and exit (cross border investment).

However, this will be considered in Phase 3 as it is important to build up domestic capabilities first.

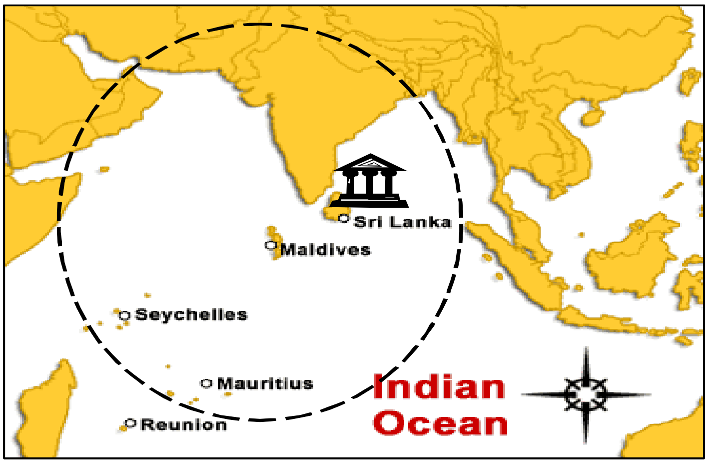
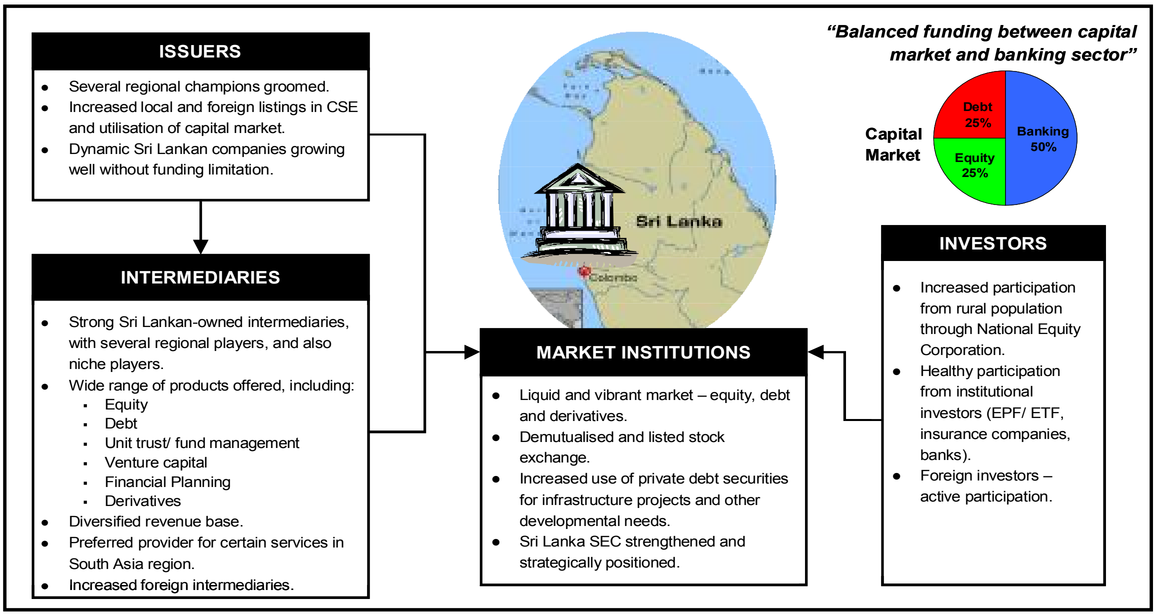


Figure 9 encapsulates the end state of the Sri Lankan capital market in 2015. The source of funding will be balanced between the capital market and banking sector. Several regional champions will be groomed. Strong and resilient Sri Lankan-owned intermediaries will compete with foreign players offering a wide range of products to cater for the various issuers and investors. Healthy participation in the capital market will be seen from both institutional investors as well as from the rural population. Finally, Sri Lanka SEC will be an institution that is effective, efficient and respected by its key stakeholders.

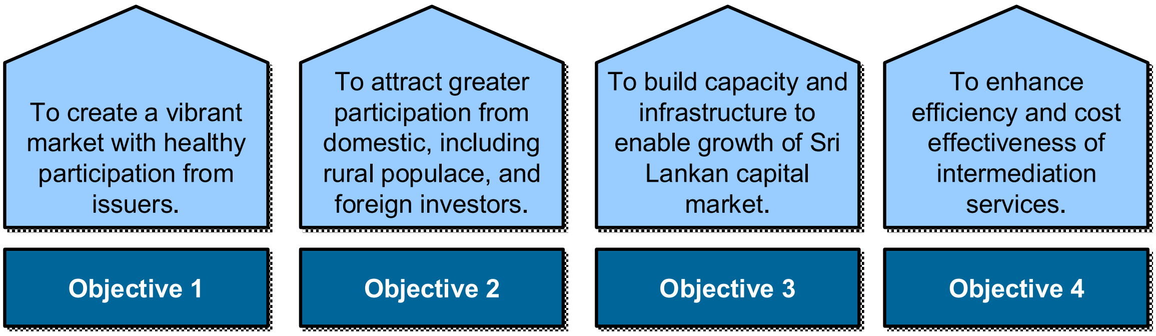
Figure 9: Vision of the Sri Lankan Capital Market in 2015



5.2 Objectives

For the shared vision to be a reality, four objectives have been crafted to support the vision. These are illustrated in Figure 10 and further elaborated below.

Figure 10: Four Objectives for the Sri Lankan Capital Market



5.2.1 Objective 1: To Create a Vibrant Market with Healthy Participation from Issuers

The intent of this objective is to create market demand and liquidity in the capital market. This objective calls for more large private corporations, SOEs and privatised Government-linked companies raise funds either through listing or raising private debt securities. The "Sri Lanka Incorporated" policy will be introduced to encourage outsourcing amongst SOEs. A vibrant corporate bond market will also be developed and current anomalies in the risk-reward structure of Government bonds and benchmark long-term yield curve will be addressed effectively. The National Mortgage Loan Corporation will be established and the market will also see the demutualisation of the Colombo Stock Exchange (CSE).

5.2.2 Objective 2: To Attract Greater Participation from Domestic, Including Rural Populace, and Foreign Investors

The intent of this objective is to attract investors into the capital market, both domestic and foreign. Aggressive education programmes on the capital market will be conducted to raise the sophistication of retail investors. Sri Lankans will also own a part of "Sri Lanka Incorporated" through investment in unit trusts in the National Equity Corporation. An active fund management industry, with participation from the public and private pension funds will be developed. The Code of Corporate Governance and Minority Shareholders' Watchdog (MSW) will be introduced to ensure protection for the minority shareholders and promote confidence in the market.

5.2.3 Objective 3: To Build Capacity and Infrastructure to Enable Growth of Sri Lankan Capital Market

The intent of this objective is to strengthen the capacity and capability of Sri Lanka SEC to regulate and develop the capital market. Further, the Capital Market Institute will be established to educate the public and train market participants. New capital adequacy requirements will also be introduced progressively to ensure stability in the market. Cooperation and coordination between the regulatory authorities will also be enhanced.

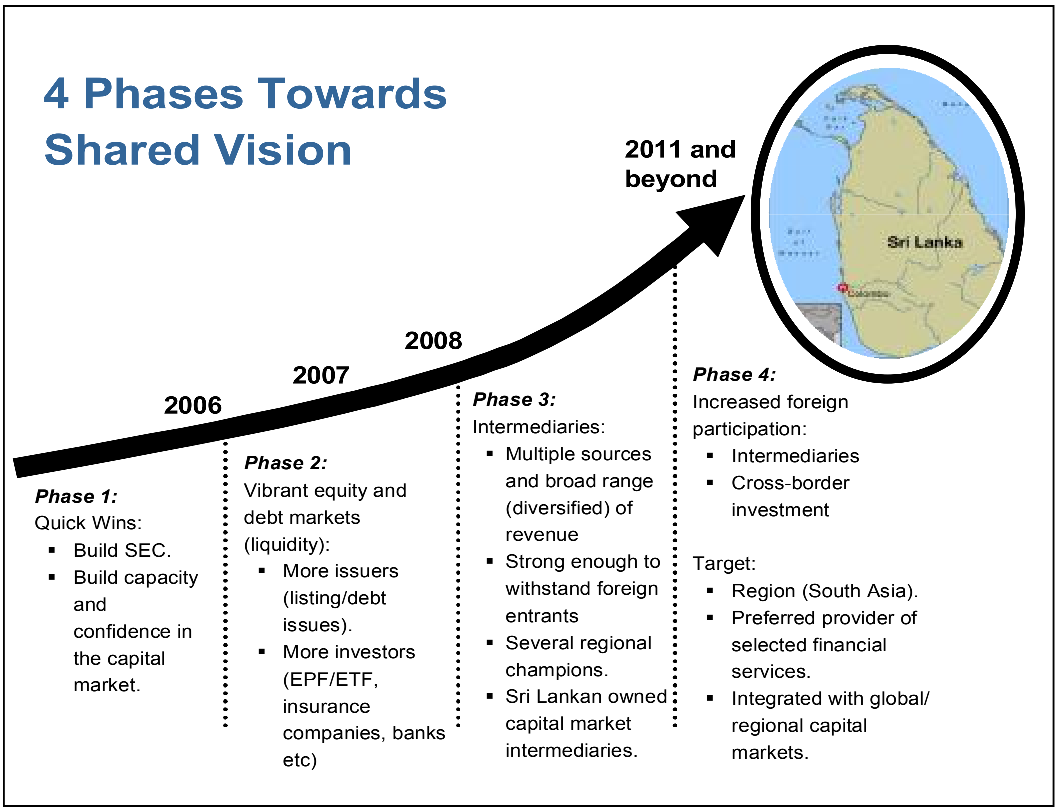
5.2.4 Objective 4: To Enhance Efficiency and Cost Effectiveness of Intermediation Services

The intent of this objective is to build a pool of strong and resilient intermediaries that are efficient, cost effective and able to offer a wide range of products and services. Tax impediments in the collective investment management industry will also be reviewed and removed. Lastly, the development of the financial planning industry will also be encouraged.

5.3 Phases

There will be four phases to achieve the shared vision. Phases 1 to 3 will overlap each other.

Figure 11: Four Phases for the Sri Lankan Capital Market



Phase 1 will be the "quick win" phase. As implementation has fallen short in the past, it is important to focus on limited number of initiatives in the first 12 months of the Master Plan to create quick wins. Hence, 12 recommendations have been prioritised for focused implementation over the coming 12 months to build Sri Lanka SEC and to build confidence in the capital market.

Figure 12: Twelve Recommendations for "Quick Wins"

ISSUERS	1	Groom one (1) SOE to list at least 10% of its equity on CSE by end of 2007.
	2	Develop program to encourage privatised SOEs under the Strategic Enterprise Management Agency's (SEMA) stable to participate in the capital market.
	3	Introduce "Sri Lanka Incorporated" policy to encourage outsourcing and infrastructure concessions amongst private sectors and SOEs.
	4	Groom 10-20 large corporates to list on CSE by end of 2007.
	5	Carry out education programme for issuers on success stories and benefits of listing on the stock exchange.
INVESTORS	6	Conduct a feasibility study for a National Equity Corporation ("NEC").
	7	Encourage greater participation of Government pension funds (EPF,ETF, etc) in the capital market.
	8	Establish the Capital Market Institute to educate public and train market participants.
	9	Conduct customised education programmes on the capital market to retail investors and school/university students.
PROD-UCTS	10	Develop a comprehensive programme to develop a vibrant corporate bond market.
SEC	11	Strengthen SEC's structure and capabilities to balance its nurturing and enforcement roles.
	12	Increase human capital in key areas of SEC, especially in its "nurturing" role.

Phase 2 will be to build a vibrant and liquid equity and debt market over a period of 2 years. Phase 3 will look into building the capacity of intermediaries and grooming of several regional champions. Once the domestic capacity and capabilities are developed, Phase 4 will be to position Sri Lanka as a niche for foreign investors and to open up the markets for foreign intermediaries to participate.

Section 6.0 Recommendations

This section focuses on the forty four (44) recommendations to push forward the Sri Lanka capital market towards its shared vision.

These recommendations are organised according to the four (4) objectives envisioned earlier.

6.1 Objective 1 – To Create a Vibrant Market with Healthy Participation from Issuers

There are twenty (20) recommendations supporting Objective 1.

Recommendation 1:
Groom one (1) SOE to list at least 10% of its equity on CSE by end 2007.

This recommendation aims to encourage further listing by SOEs in the capital market. This should be implemented in Phase 1 by Sri Lanka SEC and CSE, supported by relevant market intermediaries.

It is important to recognise that the capital market can fund the entire range or Sri Lankan Government organization/entities as reflected in the chart below.

	Government departments / agencies	Government fully owned companies	Government partially owned / (or not) owned companies with private sector	Government partially owned companies listed on CSE	National Champions Profitability efficiency	Regional / World Champions
Situation	▪ Not attractive to convert to company / corporate	▪ Resistance to privatisation • Bad experience • Lack ownership • Enormous political reaction	▪ 100 entities privatised ▪ Not all are listed ▪ Not all are profitable	▪ 14 of them ▪ Can be groomed further to enhance profitability	▪ Furniture has industry – a good success story	▪ Regional/world champions in plantation and garments but not modernised
Possible interven-tion	▪ Concession to private sector ▪ Allow listing of IPC	▪ Outsource of certain functions	▪ Government linked companies transformation program	▪ Government linked companies transformation program	▪ Groom one-on-one for listing on CSE ▪ Assist to build them into national champions	▪ Groom one-on-one for listing on CSE ▪ Assist to build them into world/regional champions, including infrastructure at estates (housing, roads, new crops, research, etc)
Capital market role	▪ Listing of IPC ▪ Securitisation of cash flow for concession projects and rental income	▪ Listing of companies providing outsourcing function ▪ Securitisation of cash flow	▪ Listing on the CSE ▪ Private debt securities	▪ Raise equity/debt funding from capital market	▪ Listing on CSE	▪ Listing on CSE ▪ Housing/mortgage securitisation ▪ PDS ▪ Derivatives products
Example	▪ Railway line/ Port authority /Electricity Board /UDA/ Highway	▪ Banks	▪ Shell/Airlines/Steel		▪ Furniture	▪ Plantation/Garments

In implementing this recommendation, three SOEs with significant listing potential and commitment from its stakeholders and management should be identified and groomed. The selected SOE should have the most positive impact on the capital market upon listing.

The listing of SOEs should be aggressively promoted to encourage other SOEs to follow suit, as well as to the investing public to generate substantive interest in the capital market.

Recommendation 2:

Groom one (1) SOE to issue private debt securities by end 2008.

This recommendation aims to encourage SOEs to issue private debt securities in the capital market. It should be implemented in Phase 2 by Sri Lanka SEC, supported by relevant market intermediaries.

Similar to Recommendation 1, in implementing this recommendation, three SOEs with significant need for capital, and healthy future cash flow projections should be identified and groomed. The selected SOEs should have the most positive impact on the capital market upon. The issue of private debt securities by the SOEs should be aggressively promoted to encourage other SOEs to follow suit and also marketed to publicise the success.

Recommendation 3:

Develop programme to encourage privatised SOEs within the Strategic Enterprise Management Agency's (SEMA) stable to participate in the capital market.

This recommendation aims to encourage greater participation by privatised SOEs in the capital market. It should be implemented in Phase 1 by the Ministry of Finance and Planning and SEMA, supported by Sri Lanka SEC.

The terms of reference and implementation plan for the programme should be developed with the aim of encouraging greater participation and reliance by privatised SOEs in the capital market.

Recommendation 4:
Conduct annual dialogue with industry players.

This recommendation would provide a platform to seek feedback and address capital market related issues. Feedback from this dialogue on the current and future initiatives to be implemented would provide input to Sri Lanka SEC. This recommendation should be implemented by Sri Lanka SEC starting in Phase 2.

Recommendation 5:
Groom 10-20 large corporates to list on CSE by end 2007.

This recommendation aims to encourage listing by large private corporates in the capital market. This should be implemented in Phase 1 by the relevant market intermediaries, supported by Sri Lanka SEC and CSE.

In implementing this recommendation, 10-20 large corporates with significant listing potential should be identified and groomed. The listing by the corporates should be aggressively promoted to encourage other corporates to follow suit.

Recommendation 6:
Groom 10-20 large corporates to issue private debt securities by end 2008.

This recommendation aims to encourage issuance of private debt securities by large private corporates in the capital market. It should be implemented in Phase 2 by the relevant market intermediaries, supported by Sri Lanka SEC.

Similar to Recommendation 5, in implementing this recommendation, 10-20 large corporates with significant need for capital should be identified and groomed. The listing by the corporates should be aggressively promoted to encourage other corporates to follow suit.

Recommendation 7:

Introduce "Sri Lanka Incorporated" policy to encourage outsourcing and infrastructure concessions amongst the private sector and SOEs.

This recommendation aims to reduce the administrative and financial burden of the Government and encourage greater participation by the private sector and SOEs in the capital market. This should be implemented in Phase 1 (quick win) by the Ministry of Finance and Planning, supported by SEC.

There are two (2) possible options. Firstly, for existing Government entities, they could outsource non-value added / repetitive activities to the private sector to enhance efficiency. These private sector entities can go to the capital market to raise funds to finance the outsourcing programme.

Secondly, due to the immense need of infrastructure in Sri Lanka coupled with limited Government financial resources, there are opportunities to leverage on the capital market for funding. This can be achieved by awarding concessions to the private sector (local and foreign, including SOEs) to develop the infrastructure using private sector financing. Again, these entities can utilise the capital market to raise funds.

In developing the policy, outsourcing and infrastructure concessions policies adopted by Governments in other countries should be studied and customised to Sri Lanka's environment. An implementation plan should be developed once potential outsourcing and infrastructure concession opportunities have been identified.

Recommendation 8:

Carry out education programme for issuers on success stories and benefits of listing on the stock exchange.

This recommendation aims to increase awareness amongst issuers as well as address any apprehensions regarding the capital market. This should be implemented in Phase 1 by Sri Lanka SEC and CSE, complemented by market intermediaries.

In implementing this recommendation, 100 or more potential issuers should be identified and invited to road shows, with each session limited to 5-10 issuers. In certain cases, targeted one-to-one session may be required. Existing listed corporates should be invited to share experiences during these road shows. Follow-up sessions should be organised with keen potential issuers and assistance should be provided where possible.

Recommendation 9:

Establish counter on the CSE for the listing of specific Infrastructure Project Companies (IPCs).

This recommendation, which complements Recommendation 7, aims to attract more corporates to list and source funds from the capital market for large-scale infrastructure concessions. This would help fund infrastructure projects in Sri Lanka. It should be implemented in Phase 2 by Sri Lanka SEC and CSE.

In implementing this recommendation, practices and requirements imposed on IPCs in other countries should be studied and customised to Sri Lanka's environment. For example, the requirements adopted for IPCs in Malaysia include:

- No historical profit track record required.
- No market capitalisation test required.
- Moratorium on sale of shares by promoters for a period of two years.
- Proceeds to be strictly used for the project and subject to regular audits.

Upon determining the IPC requirements, an Exposure Draft should be developed and circulated for comments prior to implementation.

Recommendation 10:

Establish counter on the CSE for the listing of specific high-technology companies.

This recommendation aims to provide an avenue for high-growth companies to raise capital and promote technology intensive industries, and hence assist in developing the science and technology industry for Sri Lanka. This would also provide investors with opportunities to invest in high-growth sectors. It should be implemented in Phase 3 by Sri Lanka SEC and CSE.

Similar to Recommendation 9, in implementing this recommendation, practices and requirements imposed on high-technology counters in other countries should be studied and customised to Sri Lanka’s environment. For example, the requirements adopted for high-technology counters in Malaysia include:

- No historical profit track record required.
- No market capitalisation test required.
- Moratorium on sale of shares by promoters for a period of two years.
- Proceeds to be strictly used for the project and subject to regular audits.

Upon determining the high-technology requirements, an Exposure Draft should be developed and circulated for comments prior to full implementation.

Recommendation 11:
Encourage foreign corporates to list in CSE.

This recommendation aims to enhance the value of CSE and investors confidence in the CSE as well as spur interest amongst other local and foreign corporates to list. This should be implemented in Phase 4 by Sri Lanka SEC and CSE.

In implementing this recommendation, three (3) to five (5) foreign corporates that would have the greatest positive impact on the capital market should be identified and groomed. The listing of these foreign corporates should be aggressively promoted to encourage other foreign corporates to follow suit.

Recommendation 12:
Develop a comprehensive programme to develop a vibrant corporate bond market.

This recommendation aims to facilitate the development of a vibrant corporate bond market. It should be implemented in Phase 1 by Sri Lanka SEC and Central Bank of Sri Lanka (CBSL).

In implementing this recommendation, the terms of reference for the programme should be developed and agreed on, emphasising on two (2) key objectives:

- To increase the issuance of corporate bonds.
- To increase the secondary trading of corporate bonds.

The programme should include amongst others, marketing and promotions plans, new incentives and tax rationalisation / breaks.

Recommendation 13:

Address the anomaly in the risk reward structure of Government bonds with private debt securities.

This recommendation aims to make it more financially attractive for corporates to issue bonds, hence, spurring more activity in the corporate bond market. In implementing this recommendation, factors contributing to this anomaly should be identified and confirmed. In developing the mitigating strategies and implementation plan, bond pricing practices adopted by other countries should be studied and considered.

This recommendation should be implemented in Phase 2 by the Ministry of Finance and Planning, supported by CBSL and Sri Lanka SEC.

Recommendation 14:

Establish the benchmark long-term yield curve for the bond market.

This recommendation aims to provide the prospective issuers of bonds (e.g., the Sri Lankan Government and corporates) with appropriate bond pricing linking to the varying tenures. It should be implemented in Phase 2 by the Ministry of Finance and Planning, supported by CBSL and Sri Lanka SEC.

In implementing this recommendation, factors hindering the development of the long-term yield curve should be identified and confirmed. Practices adopted by other countries should be studied and considered, for example issuance of Government index-linked bonds with tenure of 10 years or more, in developing the mitigating strategies and implementation plan.

Recommendation 15:

Allow listing and trading of Asset-Backed Securities (ABS).

This recommendation aims to the enhance liquidity in the capital market by allowing ABS to be listed and traded in CSE. This should be implemented in Phase 2 (in tandem with

Recommendation 16) by Sri Lanka SEC and CSE, supported by the CBSL.

In implementing this recommendation, the regulatory framework and listing guidelines for ABS should be developed and introduced. The relevant tax issues affecting ABS should be addressed. Application of other regulatory regime currently governing securitisation (if any) should be studied and adopted where appropriate.

Recommendation 16:
Develop a conceptual plan to establish the "National Mortgage Loan Corporation".

This recommendation aims to enhance liquidity in the capital market whereby the National Mortgage Loan Corporation would acquire mortgage loans from banks and other institutions while issuing listed securitised instruments against the same. This recommendation should be implemented in Phase 2 by the Ministry of Finance and Planning, supported by Sri Lanka SEC and CBSL.

In implementing this recommendation, the terms of reference for the conceptual plan should be developed and agreed on, emphasising on two (2) key objectives:

- To develop the secondary mortgage market.
- To enhance the capital market, particularly the private debt securities market, through widening and deepening the scope of securitisation.

Recommendation 17:
Establish the "National Mortgage Loan Corporation".

This recommendation aims to implement the conceptual plan developed in Recommendation 16. This should be implemented in Phase 3 by the Ministry of Finance and Planning, supported by Sri Lanka SEC and CBSL.

Recommendation 18:
Enforce the conversion of accounts to the Central Depository System (CDS).

This recommendation aims to ensure that all listed securities are in the CDS with the aim of enhancing the effectiveness and efficiency in the secondary trading and settlement of securities. Currently, 65% of listed equity shares and 60% of listed corporate debt are still not registered with CDS. This recommendation should be implemented in Phase 2 by CSE.

CSE and Central Depository Agent (CDA) should enforce a deadline with penalties for all holders of security document to register with CDS irrespective as to whether they are held for secondary trading or for long-term investment.

Recommendation 19:

Implement a programme to enhance CSE's value recognition both domestically and internationally.

This recommendation aims to boost market credibility, which in turn helps to attract more issuers, investors and intermediaries into the market. The programme should address, amongst others, CSE's value proposition, Sri Lanka's economic value and performance and concerns regarding the political climate to counter any negative views.

In developing the value recognition programme, CSE should consider:

- Organising a yearly fund managers conference in Colombo.
- Participating actively in international conferences.
- Conducting regular road shows both locally and internationally.

This recommendation should be implemented in Phase 2 by CSE.

Recommendation 20:

Demutualise CSE and list on the stock market.

This recommendation aims to enhance the efficiency, transparency and accountability of CSE. This should be implemented in Phase 3 by Sri Lanka SEC and CSE; and not any sooner because:

- There is a need to enhance the value of CSE prior to demutualisation and listing. This can only be done through encouragement of more primary listing and secondary trading.
- The demutualisation and subsequent listing exercise will require significant effort and will inadvertently distract the CSE from the more pressing need currently to develop

the capital market.

- The CSE is managed today rather independently from the stock brokers, as compared to other jurisdictions. Thus, the need for a demutualisation to address such issue is lesser in CSE.

In demutualising the CSE, lessons learnt from demutualisation experiences of other global exchanges should be studied and considered. Amongst the end objectives include:

- Demutualisation must enhance the market, in terms of value, liquidity, and market perception.
- The stock exchange must be more efficient and independent after demutualization.
- Interest of all stakeholders' need to be considered.

A demutualisation plan should be developed, addressing in detail the valuation, scheme and timing for the demutualisation.

One key aspect to consider in the demutualisation is the allocation of shares upon demutualisation prior to listing. Lessons learnt from other jurisdictions on this should be incorporated into the plan. For example, in Singapore and Malaysia, the respective exchanges allocated their shares to a number of parties besides the exchange members / stock brokers, including:

- Singapore
    - Singapore Exchange Ltd members (28%).
    - SEL Holdings Pte Ltd (owned by the Singapore Government) (25%).
    - New Investors (47%).
- Malaysia
    - Establishment of a Capital Market Development Fund (30%).
    - Ministry of Finance (30%).
    - Licensed Stock Broking Companies (30%).
    - Eligible Remisiers (10%).

6.2 Objective 2: To Attract Greater Participation from Domestic, Including Rural Populace, and Foreign Investors

There are altogether fourteen (14) recommendations aligned to this Objective 2.

Recommendation 21:
Conduct a feasibility study for a National Equity Corporation (NEC).

This recommendation aims to encourage greater participation and wealth creation, especially among rural populace whist enhancing capital market participation and liquidity. This recommendation is deemed critical by the Sri Lankan Government and should be implemented in Phase 1 by the Ministry of Finance and Planning, supported by Sri Lanka SEC.

The terms of reference for the feasibility study should be developed and agreed on, emphasising on three (3) key objectives:

- To encourage greater participation especially among rural populace in the capital market.
- To cultivate widespread savings habits and wealth creation among the urban and rural populace.
- To enhance capital market liquidity.

The successful NEC model in Malaysia should be studied in detailed and customised to Sri Lanka's environment as the situation in Sri Lanka is different from there in Malaysia.

Recommendation 22:
Establish NEC.

Based on the findings of Recommendation 21, the NEC should be established in Phase 2 by the Ministry of Finance and Planning, supported by Sri Lanka SEC.

Recommendation 23:

Conduct customised education programmes on the capital market to retail investors and school / university students.

This recommendation aims to increase awareness of capital market products and services amongst retail investors as well as students especially those outside Colombo city. This should be implemented in Phase 1 by Sri Lanka SEC.

To enhance effectiveness, the programmes should be customised and profiled by region / location, audience, and income groups.

Sri Lanka SEC should also work with the Ministry of Education to incorporate capital market as part of the education syllabus for schools and universities. Sri Lanka SEC should also identify and leverage on the appropriate communication channels to meet the programme objectives. For example,

- Television and radio.
- Personalised meetings.
- Seminars and workshops.
- Direct mail / e-mail campaign.
- Internet.
- Kiosk.

Recommendation 24:

Encourage greater participation of Government pension funds (EPF and ETF, etc.) in the capital market.

This recommendation aims to enhance investment activity in the capital market by encouraging organisations such as EPF and ETF to diversify their portfolio and invest more proportion into the capital market. This should be implemented in Phase 1 by Sri Lanka SEC and CBSL.

In implementing this recommendation, investment practices adopted by similar organisations in comparable countries should be studied and considered. Sharing / discussion sessions with the EPF and ETF should be organised to share findings of studies as well as to obtain commitment.

Recommendation 25:

Encourage EPF and ETF to diversify the management of its funds by outsourcing 5% to external fund managers.

This recommendation aims to develop the fund management industry by outsourcing captive funds to professional private fund managers. This recommendation should be implemented in Phase 2 by EPF and ETF.

Sharing / discussion sessions between EPF and ETF with the private fund managers should be organised to obtain commitment and to develop the implementation plan. The implementation plan should address amongst others, the following:

- Performance based fee.
- Sharing of losses.
- Risk management mechanisms.
- Monitoring and reporting mechanisms.

Recommendation 26:

Encourage SOEs to increase their investment portfolio in the capital market.

This recommendation aims to enhance investment activity in the capital market by encouraging greater investment by State-Owned Enterprises in the capital market. It should be implemented in Phase 2 by SEC and the Central Bank of Sri Lanka.

In implementing the recommendation, SEC and Central Bank should research and identify State-Owned Enterprises with potential for greater participation in the capital market. Following which Sharing / discussion sessions with potential State-Owned Enterprises should be organised to obtain commitment.

Recommendation 27:

Pursue measures to outsource the management of funds by insurance companies.

Similar to Recommendation 25, this recommendation aims to boost the private fund management industry by encouraging insurance companies to outsource the management of funds to the private fund managers. This recommendation should be carried in Phase 2 by the respective insurance companies.

Sharing / discussion sessions between the insurance companies and private fund managers should be organised to obtain commitment and to develop the implementation plan. The implementation plan should address amongst others, the following:

- Performance based fee.
- Sharing of losses.
- Risk management mechanisms.
- Monitoring and reporting mechanisms.

Recommendation 28:
Pursue measures to facilitate the development of private pension industry.

This recommendation aims to enhance the role of private pension industry in the provision and management of funds and its participation in the equity market. This should be implemented in Phase 3 by Sri Lanka SEC and the CBSL.

A feasibility study should be undertaken prior to implementation. The study should cover, amongst others:

- Review of current mandatory contribution structure.
- Factors hindering the development of private pension industry.
- Scope for greater use of private pension schemes.
- Tax and other incentives required to develop the industry.

Recommendation 29:
Reinstate All Share Price Index (ASPI) on the Morgan Stanley Capital Index (MSCI).

This recommendation aims to enhance CSE's international standing with the intention of attracting foreign investors as well as a platform to address negative international publicity. This should be implemented in Phase 2 by the Sri Lanka SEC and CSE.

Sri Lanka SEC and CSE should organise discussions with Morgan Stanley on MSCI requirements for reinstatement as well as to address negative international publicity. Aggressive promotion should be undertaken to inform market stakeholders' once ASPI has been reinstated.

Recommendation 30:

Encourage CSE to pursue appropriate strategic alliances internationally with leading regional bourses.

This recommendation aims to address the increasingly borderless nature of capital markets. Successful capitalisation on the expertise and market share of alliances will allow the CSE access to a wider range of investors. This should be implemented in Phase 3 by the CSE.

CSE should organise discussions with representatives from leading regional bourses with the aim of identifying strategic alliance opportunities for collaboration on technical matters and also joint marketing purposes.

Recommendation 31:

Adopt and mandate the recommendations contained in the proposed Code of Corporate Governance.

This recommendation aims to enhance corporate accountability and stakeholders' confidence in the companies listed on CSE. This recommendation should be implemented in Phase 2 by Sri Lanka SEC and CSE.

Sri Lanka SEC and CSE should develop an implementation plan for the Code of Corporate Governance. Existing laws and regulations and rules should be streamlined to support the effective implementation of the Code. Ongoing discussion and communication with market stakeholders and general public should be undertaken to ensure effective implementation.

Recommendation 32:

Establish Minority Shareholders Watchdog (MSW) to safeguard shareholders' interest.

This recommendation aims to promote and preserve minority shareholders' rights and confidence by effectively monitoring potential abuse by controlling shareholders. This should be implemented in Phase 3 by Sri Lanka SEC.

In implementing this recommendation, research on the establishment of MSW in other countries should be conducted. Sri Lanka SEC should develop an implementation plan for the establishment of the MSW. The plan should address the structure, governance, funding and activities for the MSW.

Recommendation 33:

Re-assess the need and timing for venture capital industry.

This recommendation aims to reassess the future prospects for the venture capital industry in Sri Lanka. It should be conducted in Phase 3 by Sri Lanka SEC and CBSL.

The reason for not prioritising this recommendation earlier is because the other sectors of the capital market requires more urgent focus.

A feasibility study should be undertaken. The study should cover, amongst others:

- Status and barriers hindering the growth of the venture capital industry.
- Prospects and readiness of the venture capital industry.
- Tax and other incentives required to develop the industry.

Recommendation 34:

Re-assess the need and timing for derivatives products.

This recommendation aims to determine the prospects and readiness for introduction of derivatives products in Sri Lanka. This should be implemented in Phase 4 by Sri Lanka SEC and CBSL, and not earlier, due to the lower priority towards these products by the stakeholders of the Sri Lankan capital market.

Sri Lanka SEC and CBSL should review the feasibility and timing for a derivatives market in Sri Lanka based upon the findings of the feasibility study on derivatives undertaken by the Korea International Cooperation Agency and other relevant studies.

6.3 Objective 3: To Build Capacity and Infrastructure to Enable Growth of Sri Lankan Capital Market

There are six (6) recommendations under this Objective 3.

Recommendation 35: **Strengthen Sri Lanka SEC's structure and capabilities and to balance its development and enforcement roles.**

This recommendation aims to strengthen Sri Lanka SEC's structure to be reflective of the developing capital market in Sri Lanka which requires more nurturing and hand-holding. This recommendation should be implemented in Phase 1 by Sri Lanka SEC.

In implementing this recommendation, research on organisation structures adopted by other Securities Commissions in developing capital market should be carried out. Based on the benchmark studies, Sri Lanka SEC should then increase its capacity in the developmental role by incorporating new functions such as marketing and promotions, business development and strategic planning.

Recommendation 36: **Increase human capital in key areas of Sri Lanka SEC, especially in its "nurturing" role.**

This is to support the new Sri Lanka SEC organisation structure (Recommendation 35) in regulating and developing the capital market. This recommendation should be implemented in Phase 1 by Sri Lanka SEC.

Based on research and benchmarking, Sri Lanka SEC should determine the additional human capital required to support its new organisation structure. A recruitment plan should also be developed.

Recommendation 37:

Establish the Capital Market Institute to educate the public and train market participants.

This recommendation aims to enhance the knowledge of professionals and the general public on the capital market. This should be implemented in Phase 1 by Sri Lanka SEC.

In implementing this recommendation, research on the establishment of similar institutes in other countries should be conducted. Sri Lanka SEC should develop an implementation plan covering:

- Programmes to be offered.
- Programme developers and facilitators.
- Participants to be trained.
- Set-up and operational funding requirements.
- Resource centre.
- Regional training arrangements.

Recommendation 38:

Expand regulatory coverage of Sri Lanka SEC to cover other capital market intermediaries and products.

Certain capital market intermediaries and products are currently not regulated by Sri Lanka SEC. Market intermediaries and products currently not governed, include investment banks, private provident funds and private debt securities. This recommendation aims to address the unwarranted risks arising from these unregulated capital market intermediaries and products.

In implementing this recommendation, laws, regulations and rules should be streamlined to support effective regulation. Monitoring and reporting systems should be implemented for effective enforcement of regulations.

This recommendation should be implemented in Phase 2 by the Ministry of Finance and Planning, supported by Sri Lanka SEC and CBSL.

Recommendation 39:

Strengthen the capital adequacy requirements to reduce systemic risk in the market.

Trading volumes handled by the stock brokers in Sri Lanka are significantly higher than the imposed capital requirements. This recommendation aims to reduce the systemic risk in the capital market. This recommendation should be implemented in Phase 2 by Sri Lanka SEC and CSE.

Sri Lanka SEC has developed an Exposure Draft on the capital adequacy requirements. Sri Lanka SEC should reassess the Exposure Draft and, if necessary, benchmark with other countries. An effective monitoring and reporting system should be implemented for effective enforcement of capital adequacy requirements.

Recommendation 40:

Enhance co-operation and co-ordination between regulatory authorities.

This recommendation aims to strengthen market oversight and to ensure consistency and effectiveness in implementing programmes. This recommendation should be implemented in Phase 3 by the Ministry of Finance and Planning, supported by Sri Lanka SEC, CBSL and Insurance Board of Sri Lanka.

In implementing this recommendation, a Memorandum of Understanding (MOU) between the regulatory authorities (Sri Lanka SEC, CBSL and Insurance Board) should be executed. Quarterly co-ordination meetings to address market related issues and implementation of programmes should also be organised.

6.4 Objective 4: To Enhance Efficiency and Cost Effectiveness of Intermediation Services

Four (4) recommendations have been identified for this Objective 4.

Recommendation 41: **Widen the scope of capital market services offered by stockbroking companies.**

This recommendation aims to diversify the income streams of stockbroking companies from brokerage commissions to reduce vulnerability to the vagaries of market cycles. This should be implemented in Phase 2 by Sri Lanka SEC. Laws, regulations and rules should be streamlined to support effective implementation.

The additional scope of services to be considered for the stockbroking companies should include:

- Dealing in derivatives.
- Fund management services.
- Corporate finance.
- Lead and sub-underwriting.
- Debt trading and advisory.

Recommendation 42: **Liberalise stockbroking commission rates.**

This recommendation is necessary to reflect the scope, quality and efficiency of services rendered by stockbrokers as the market moves towards a more competitive environment. This should be implemented in Phase 3 by Sri Lanka SEC and CSE after the strengthening of the local stock brokers in Phase 2 though the widening of scope of services. Laws, regulations and rules should be streamlined to support effective implementation.

An Exposure Draft should be developed to liberalise stockbroking commissions. In developing the Exposure Draft, Sri Lanka SEC should:

- Benchmark with other jurisdictions on practices adopted for stockbroking commission rates.

- Consider reduction of costs for Sri Lanka SEC and CSE.
- Introduce safeguard measures to protect the interest of investors especially retail investors.

Recommendation 43:
Review tax regime to encourage investments in collective investment schemes.

This recommendation is necessary to address the unfavorable tax regime imposed on the collective investment industry, hindering its growth. This recommendation should be implemented in Phase 2 by Sri Lanka SEC, CBSL and Inland Revenue Board.

In implementing the recommendation, review of tax issues affecting the collective management industry in Sri Lanka as well as research on tax practices adopted in leading markets should be undertaken. Discussion sessions with key stakeholders should be organised to share findings and obtain commitment to implement mitigating actions.

Recommendation 44:
Encourage development of financial planners.

This recommendation is to broaden consumer awareness of the different products and strategies available to them by providing personalised professional financial planning services. This should be implemented in Phase 3 by the Sri Lanka SEC and CBSL.

The establishment of the Financial Planners Association should be considered. The Association should have a business plan that will address, amongst others:

- Membership requirements.
- Membership recruitment strategy.
- Service offerings.
- Continuous Professional Education.
- Association funding requirements.

Laws, regulations and rules should be introduced to ensure effective governance of financial planners.

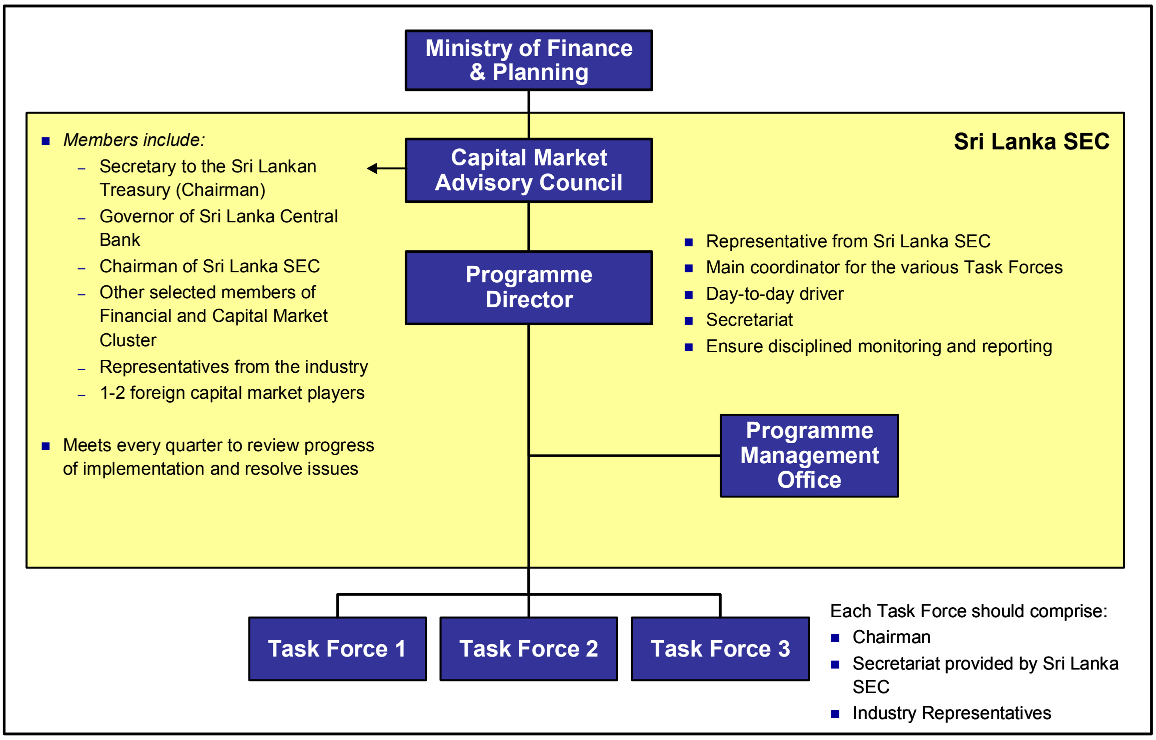
Section 7.0 Implementation Framework

7.1 Implementation Structure

Sri Lanka SEC will be the primary driver of the Master Plan implementation, reporting periodically to the Ministry of Finance and Planning. It will implement the recommendations that directly affect its areas of responsibility, undertake measures to facilitate value creation for the capital market as well as train and educate investors and participants. It will also ensure sufficient resources to promote and facilitate the smooth implementation of the Master Plan.

Each party in the implementation structure has its roles and responsibilities. The Capital Market Advisory Council will be the key driver. The Programme Director will ensure the implementation of the Master Plan on a daily basis. He/She will be supported by a Programme Management Office (PMO). The implementation structure is shown in Figure 13.

Figure 13: Implementation Structure



The parties involved and the roles and responsibilities are described below.

7.1.1 Ministry of Finance & Planning

Ultimately, Sri Lanka SEC will report progress of the implementation to the Ministry of Finance & Planning. Aside from monitoring and reviewing progress of the implementation, the Ministry will also provide strategic input and where necessary, facilitate amendments and/or development of policies.

7.1.2 Capital Market Advisory Council

The Capital Market Advisory Council meets every quarter to review the progress of the implementation and resolve issues. Its members are made up of:

- Secretary to the Sri Lankan Treasury (Chairman).
- Governor of CBSL.
- Chairman of Sri Lanka SEC.
- Other selected members of the Financial and Capital Market Cluster.
- Representatives from the industry (Stockbrokers Association, CSE, investment banks, fund managers, primary dealers, Unit Trust Association, Credit Rating Agencies, Chairman and CEOs of large corporations).
- 1-2 foreign capital market players.

The Capital Market Advisory Council will advise Sri Lanka SEC on the following:

- Developments in the capital markets globally and regionally, and their potential implications for Sri Lanka.
- Independent view on the progress of the implementation of recommendations.
- Areas that necessitate revision of recommendations to reflect the evolving environment.

7.1.3 Programme Director

The Programme Director will be a representative from Sri Lanka SEC. He/she will:

- Ensure disciplined monitoring and reporting.
- Drive day-to-day implementation.
- Be the main coordinator between Sri Lanka SEC with the various Task Forces and the PMO.

7.1.4 Programme Management Office

The PMO will be headed by Sri Lanka SEC, supported by the Secretariat. The functions of the PMO include:

- Co-ordinate implementation recommendations, including liaising with various Tasks Forces and other relevant agencies.
- Identify issues and manage resolutions which may arise during implementation.
- Facilitate inter-agency co-ordination.
- Monitor progress and assess performance based on specific criteria.
- Co-ordinate and drive communication programmes.

7.1.5 Task Force

Each Task Force should comprise a Chairman, Secretariat provided by Sri Lanka SEC and representatives from the industry. The functions of the Task Force include:

- Ensure operational implementation of various recommendations.
- Liaise and consult with the relevant government agencies, industry participants, professional bodies, and other stakeholders in the implementation of recommendations.
- Obtain approvals from the various authorities, and enable the overall monitoring and co-ordination of tasks in implementation.

7.2 Implementation Plan

The development of the Sri Lankan capital market will be carried out over four phases as outlined in Section 5.0 as shown in Figure 14.

Figure 14: Implementation Plan

Phases	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Phase 1: Quick Wins										
Phase 2: Build Markets										
Phase 3: Build Capacity – Intermediaries										
Phase 4: Positioning as Niche for Foreign Investors										

The 44 recommendations are also sequenced by the four phases as shown in Table 1.

Table 1: Sequencing of Recommendations

Recommendations	Phase 1	Phase 2	Phase 3	Phase 4
1. Groom one (1) SOE to list at least 10% of its equity on CSE by end 2007.				
2. Groom one (1) SOE to issue private debt securities by end 2008.				
3. Develop programme to encourage privatised SOEs under the Strategic Enterprise Management Agency's (SEMA) stable to participate in the capital market.				
4. Conduct annual dialogue with industry players.				
5. Groom 10-20 large corporates to list on CSE by end 2007.				
6. Groom 10-20 large corporates to issue private debt securities by end 2008.				
7. Introduce "Sri Lanka Incorporated" policy to encourage outsourcing and infrastructure concessions amongst the				

Recommendations	Phase 1	Phase 2	Phase 3	Phase 4
private sector and SOEs.				
8. Carry out education programme for issuers on success stories and benefits of listing on the stock exchange.				
9. Establish counter on the CSE for the listing of specific Infrastructure Project Companies (IPCs).				
10. Establish counter on the CSE for the listing of specific high-technology companies.				
11. Encourage foreign corporates to list in CSE.				
12. Develop a comprehensive programme to develop a vibrant corporate bond market.				
13. Address the anomaly in the risk reward structure of Government bonds with private debt securities.				
14. Establish the benchmark long-term yield curve for the bond market.				
15. Allow listing and trading of Asset-Backed Securities (ABS).				
16. Develop a conceptual plan to establish the "National Mortgage Loan Corporation".				
17. Establish the "National Mortgage Loan Corporation".				
18. Enforce the conversion of accounts to the Central Depository System (CDS).				
19. Implement a programme to enhance CSE's value recognition both domestically and internationally.				
20. Demutualise CSE and list on the stock market.				
21. Conduct a feasibility study for a National Equity Corporation (NEC).				
22. Establish NEC.				
23. Conduct customised education programmes on the capital market to retail investors and school / university students.				
24. Encourage greater participation of Government pension funds (EPF and				

Recommendations	Phase 1	Phase 2	Phase 3	Phase 4
ETF, etc.) in the capital market.				
25. Encourage EPF and ETF to diversify the management of its funds by outsourcing 5% to external fund managers.				
26. Encourage SOEs to increase investment portfolio in the capital market.				
27. Pursue measures to outsource the management of funds by insurance companies.				
28. Pursue measures to facilitate the development of private pension industry.				
29. Reinstate All Share Price Index (ASPI) on the Morgan Stanley Capital Index (MSCI).				
30. Encourage CSE to pursue appropriate strategic alliances internationally with leading regional bourses.				
31. Adopt and mandate the recommendations contained in the proposed Code of Corporate Governance.				
32. Establish Minority Shareholders Watchdog (MSW) to safeguard shareholders' interest.				
33. Re-assess the need and timing for venture capital industry.				
34. Re-assess the need and timing for derivatives products.				
35. Strengthen Sri Lanka SEC's structure and capabilities and to balance its development and enforcement roles.				
36. Increase human capital in key areas of Sri Lanka SEC, especially in its "nurturing" role.				
37. Establish the Capital Market Institute to educate the public and train market participants.				
38. Expand regulatory coverage of Sri Lanka SEC to cover other capital market intermediaries and products.				
39. Strengthen the capital adequacy requirements to reduce systemic risk in the market.				

Recommendations	Phase 1	Phase 2	Phase 3	Phase 4
40. Enhance co-operation and co-ordination between regulatory authorities.				
41. Widen the scope of capital market services offered by stockbroking companies.				
42. Liberalise stockbroking commission rates.				
43. Review tax regime to encourage investments in collective investment schemes.				
44. Encourage development of financial planners.				