New SEC Act: boon or bane?

Securities and Exchange Commission Chairman Viraj Dayaratne

A new Securities and Exchange Commission (SEC) Act was recently passed in Parliament and it was made law last week by the Speaker. Before its passage in Parliament, strong viewpoints were expressed for and against the bill and much debate erupted over it among business circles, market stakeholders, ex-regulators, etc. Following is an interview with SEC Chairman Viraj Dayaratne PC, who was a prime mover behind this piece of legislation.

After the parliamentary approval, last week, the Speaker placed his signature on the new SEC Act, making it law. How do you feel about it?

It was a long and arduous process but the present commission is happy that we were able to complete it. As you know, this law has been in the making since 2007. We were able to refine it and take away the ambiguities and other grey areas to make sure that the process of application and implementation will be a smooth one.

It was a collective effort of the previous commissions, which had done a lot of work and the present commission, which completed it. The government should be commended for taking steps to have it enacted.

But there was some strong criticism about it, specially just before the bill was to be taken up in Parliament for approval. Critics said the new act gave too much discretion to the SEC.

The drafting of this law has been done with the assistance of experts from the World Bank as well as experts from Sri Lanka.

There has been a process of wide stakeholder and public consultation. So, the act is not something that has been drafted in a hurry. I must also mention that most of the core provisions in the previous draft have been retained in the new law. I would like to point that out in the first place.

The previous law, as you know, was passed in 1987. Our market has evolved since then and it has to evolve further. So, we need to keep up with the laws that are followed in other countries. The law has to have provisions primarily to cater to the demands of our market and as the regulator, one of our prime most responsibilities is to protect investors. In order to protect investors, we have to have the necessary safeguards. Those safeguards have now been included.

You asked me if those provisions are draconian. No, they are not draconian. Some of those provisions have been included in the act as deterrents in order to discourage wrongdoings and to ensure the integrity of the market. There are checks and balances in the act to ensure that the commission acts in a fair and transparent manner.

There had been criticism at a public forum that the commission has been given very wide discretionary powers, which could be subject to abuse. What would be your response?

We welcome the expression of views and are glad that people criticised. We are happy that there was discourse about the provisions and we welcomed it.

As I said earlier, there was a long process of consultations before the act was finalised and we would have preferred if whatever provisions that were thought to be bad were brought to our attention or the attention of the previous commissions. In fact, most of this criticism came about only after the act was tabled in Parliament.
We were always ready to makes changes, if such changes were good for the market. In fact, at the committee stage, we ourselves as a commission proposed certain changes.

What were the changes made?

Well, one was about public issue of securities. What the bill contained was that if any company were to issue securities to the public and raise money from the public, they would have to obtain

the approval of the SEC. But in some instances, the commission could grant exemptions. That is what the provision said with regard to public offers.

There was some doubt then as to what will be exempted and so on. Although the law was clear, some expressed concerns as to how the commission will act because it said the commission, by way of rules, could exempt. There was concern since everybody who would make a public issue of securities would have to obtain the approval of the SEC. Actually why it had been included was to safeguard the interests of investors because you are raising money from the public. That was the rationale for its inclusion.

But practically, there may have been certain difficulties and actually the duty cast on the SEC also would have been somewhat onerous because we would then have to consider each and every request and grant approval.
We revisited that provision and we thought okay, we would put it in a different way. We will not require every issuer to obtain our approval. But in certain instances, we can by way of rules, require unlisted companies to obtain our approval. Now that is a change that we brought in.

What are the others?

There was a provision to say that market intermediaries, when advising clients, have to be responsible for the advice they tender and that the advice should be well founded. If an investor suffers loss as a result of relying on that information or advice, he can sue that intermediary to recover any loss suffered.

Now, that was seen as a provision, which would result in a lot of litigation. Of course, our position was that such relief was anyhow available under the common law. However, we decided to only recognise the duty but the specific statutory right that was conferred has now not been included. So, those were two key changes that were brought about.

Another key criticism against the act was its biasness towards investors and as a result, it was pointed out that other parties could suffer. Critics argued that this could demoralise the market.

As I said, the responsibility of the regulator is to ensure that the rights of the investors are protected and at the same time, we have to take steps to develop the market. So actually, during little over one and a half years that we have been in office, you would have seen that we have been very proactive and we took a lot of steps to develop the market and we fully recognise our role in that sphere as well.

Whilst investors rights have to be protected, in doing so, you have to ensure that the market intermediaries and all other stakeholders can perform their functions in a fair manner, without hindering their activities. I would responsibly say that there is nothing in the present law that will hinder the activities of the brokers or any other market intermediary.

If there are any new provisions that have been introduced, that is to ensure the integrity of the market, ensure that everyone adheres to best practices and also to ensure that the market intermediaries conduct their businesses in a manner that would improve the standards of their business operations and are able to provide a better service to their clients.

I must say that there is no onerous duty or new responsibility that has been tasked on any of the market intermediaries or the listed companies. As far as listed companies are concerned, a new introduction is that in the appointment of their board of directors they will have to stick to and follow the fit and proper criteria set out by the exchange or the commission in the listing rules. That happens even now as far as market intermediaries are concerned. So, that is nothing new.

There was a public consultation process with regard to the corporate governance framework, which was prepared with the participation of all stakeholders, including representatives from the chambers of commerce and listed companies. As you know, there is a cry all over the world that corporates must follow good corporate governance practices.

The other requirement as far as listed companies are concerned is that the auditor, who audits the accounts of a listed company, has to bring to the attention of the audit committee if there has been any malpractice or any wrongdoing. Then, if the audit committee doesn't put it right, the auditor is duty bound to bring it to the attention of the board of directors.

If the board of directors doesn't put it right, then depending on what the non-compliance or breach is, it must be brought to the attention of the SEC or CSE because the CSE will have to enforce listing rules. That is the other requirement as far as the listed companies are concerned and the chambers welcomed that provision. In fact, I am told that these practices are followed even now and what has been done is that they have been recognised in the new law.

So, I emphasise here that we have not introduced anything that will result in market intermediaries or corporates having to incur an additional cost.

Anyway, even now, there are rules and standards for market intermediaries. There are rules for different market segments; there are broker rules, there are margin provider rules and there are fund manager, investment manager rules. What has happened with the new act is that most of those rules and most of those responsibilities or duties that they have to abide by, have been included in the body of the act.

So, people tend think that these are new rules. No, almost 90 percent of them were already there. As I said before, they have now been brought into the act. People would think that these are coming out for the first time, no, those are anyway there.

Another criticism is that what we have is not a developed market and therefore such stringent regulation could unsettle investors, market intermediaries and prospective companies that are planning IPOs on the CSE.

No. That is not at all correct. Actually the provisions that we have in our law are catered for our market. We don't believe that our law should be similar to the laws that we find in a developed market. We have taken into consideration the nature of our market and how it will evolve in the future. So there are provisions that are required for the moment, as well as certain provisions that are required going forward.

We have to be futuristic when drafting a law. So, if certain provisions may not be all that relevant now, those have been included thinking of the future. That is all that I would like to actually emphasise on that fact.

Another key feature of the new act, which is also another bone of contention, is the introduction of civil action against market misconduct and that the commission has given up its prosecutorial discretion.

Yes, even I observed that certain views had been expressed that the SEC had given up its prosecutorial discretion. I would like to first tell you that we must understand what exactly prosecutorial discretion means so that everybody can understand it.

As far as all investigations are concerned, they are done by the SEC. Once an investigation is over, a recommendation is made to the commission. Then the commission goes into the matter and has to make a call depending on the evidence available and certain other factors.

Particularly, as far as the main market offences are concerned, the options would be to file criminal charges and now to file civil action and in certain instances considering the nature and manner of the contravention, the impact it has on the market and the extent of the loss caused to any investor to enter into an agreement to recover three times the gross amount gained or the loss suffered.

So, when you talk of prosecutorial discretion, it includes all those options. Right now, who makes that call? It is the commission and under the new law, it remains and will continue to remain, with the commission.

But when it comes to criminal action, in terms of the new law, unlike the previous law, criminal action in respect of serious market offenses like market manipulation and insider trading is to be filed in the High Court and not in the Magistrate's Court. Cases in the High Court can only be filed upon what is known as an indictment.

And the right to file an indictment in terms of the Criminal Procedure Code is vested with the Attorney General, the only exception being the power conferred on the Bribery Commission respect of bribery matters. There again, the prosecution is usually conducted by the Attorney General.

Now in this instance, the act has specifically mentioned the fact that the proceedings will be instituted and that the prosecution will be conducted by the Attorney General because that is how

it can happen in the High Court. Even in the previous bill that went to Parliament, it was stated that the prosecution shall be conducted by the Attorney General. So, it is not a new provision and it does not result in the prosecutorial discretion being vested in the Attorney General.

Another matter that I would like to emphasise is, during the course of the investigations or when the commission takes a decision, the commission on most occasions consults the Attorney General, he being the chief law officer of the state, who advises all government and semi-government institutions. So, this whole claim of the SEC giving up its prosecutorial discretion is without any foundation.

There was also this comment that with the new SEC Act coming into effect, nobody would want to sit on the director board of a listed company.

To be honest, I would also like to know why? I can't see any reason as to why anybody should fear to get on the director board of a listed company or for that matter to list a company because it is absolutely beneficial for a company to list. It's not only an opportunity to raise capital but also there are various other benefits that a company would get through listing.

Is it because under the new law, an investor can easily sue the directors of a listed company for a loss he or she incurred, due to bad decision by the board?

If an investor has any issue with a listed company, there is always a common law remedy. The act has not conferred any specific power or a right on an investor to sue a listed company. There is no need for a regulator in a regulatory law to have such a provision.

What is applicable under the present Listing Rules will continue and there are no new restrictions that have been introduced, which would inhibit a person from becoming a director.

Even the critics applauded one area of the new act. That was its tough stance on market misconduct. Can you shed some light on specific provisions in the act in this regard?

The main market offences of insider trading and market manipulation have been dealt with in a separate part. There are five different offences that have been specifically identified under market misconduct. It is important to note two offences in particular. One prevents a person from making a statement or disseminating information, which is false or misleading in a material particular that is likely to have an effect of raising or lowering the market price or volume.

The other prohibits a person from inducing or attempting to induce someone to trade by making or publishing any statement or forecast that will be misleading, false or deceptive. All five offences have been explained in detail. As far as insider trading is concerned, again how the offence can be committed has been very clearly explained. This will make it clear as to what conduct is permitted and what is not permitted.

Criminal action in respect of these main offences will now have to be filed in the High Court and the punishment that can be imposed has been enhanced. Similarly, as I said earlier, the introduction of the ability to file civil proceedings is noteworthy. As I stated earlier, the enhanced punishments that can now be imposed are expected to act as a deterrent.

But is compounding really a deterrent? In most cases, the offence is so much larger than the fine.

That has been addressed in the new act. The commission needs to take into consideration the nature and manner of the contravention, the impact it has on the market and the extent of the loss caused to any investor. As far as the main market offenses are concerned, there is provision to file a civil case or the commission can enter into an agreement with the offending party to pay with or without the admission of liability, an amount equal to three times the gross amount of the pecuniary gain made or the loss avoided.

That is a stringent provision. Even as far as non-serious market offenses are concerned, the compounding provision now is more stringent. So, there will be no way in which anybody can say that people can lightly get away after committing an offense.

Any other salient points in the act that you would like to highlight?

One area I would like to highlight is the power to impose administrative sanctions. Under the previous law, if there was a non-compliance or a breach, the remedy available to the commission was to go to the criminal court. But now there is a new provision called administrative sanctions, where the commission can take certain steps such as a reprimanding, imposing a penalty, ordering restitution, etc.

The commission is given that power but the commission has to always give a hearing to the party before such step is taken and it has to be commensurate with the wrong committed. If I were to go back to your earlier question, where more power is given to the commission, the way in which you control such power or the discretion is to have checks and balances.

Now we don't need to go into detail but there are a lot of checks and balances that have been specifically stated in the act itself to ensure that in exercising discretion the commission always acts with responsibility and in a fair manner.

The commission cannot act arbitrarily in view of these checks and balances, which have been specifically provided for and in any case, we have to remember that public authorities are always accountable for their actions and cannot exceed their authority or act outside the law.

What are the futuristic provisions in the new act for the market development?

Thank you for asking that since that is one of the areas that has been least discussed publicly. For instance, the act has recognised a category of market intermediaries called market makers. You

find them in developed markets. They assist in the efficient exchange of securities between buyers and sellers. So, that is made possible under the new law.

Then there can be collective investment schemes going beyond the present unit trusts. There can be different types of mutual funds such as gold mutual funds or hedge funds that will widen investment options. So, there's a possibility that those developments can take place.

Then we have derivatives, short selling and so on and all those can come with the CCP. Now we have implemented DVP. Our next goal within the next one year or so is to see whether we can set up a CCP.

So, these are futuristic provisions actually going forward because our market has to evolve; it can't always cater to the requirements of the retailers only and we have to have products that are available for high-net-worth investors.
One has to appreciate that the new act does not only strengthen regulation but also has many provisions that will help the market to develop and in turn, benefit economic activity of the country. The present commission has demonstrated our desire to maintain a fine balance between regulation and market development and I am sure that the new law will further strengthen the avenues available to the regulator for such purpose.