

Media Release

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SEC overhauls Regulations Governing Market Institutions, Market Intermediaries and introduces a Code for Collective Investment Schemes

The Securities and Exchange Commission of Sri Lanka (SEC), the securities market regulator has prepared Rules pertaining to Market Institutions, Market Intermediaries and a Code for Collective Investment Schemes following the enactment of the new Securities and Exchange Commission Act No. 19 of 2021. These Rules which were made in terms of the powers vested in the Commission under Section 183 of the Act. The Rules in respect of Market Institutions and Market Intermediaries were published in the Gazette Extraordinary bearing Number 2271/09 and 2271/10 dated 15 March 2022 whilst the Rules in respect of Collective Investment Schemes which will be known as the “CIS Code” was published in the Gazette Extraordinary bearing Number 2278/2 and dated 07 May 2022. They come in to force from the date of the respective Gazette Notices.

The key components of the Rules for the three Market Institutions, namely an Exchange, a Central Depository and a Clearing House, include the licensing procedure, minimum financial requirements, reporting and infrastructure requirements, governance structures, compliance and internal controls etc. In addition, these Rules embody detailed criteria for fitness and propriety of key management persons of market Institutions and has introduced the important role of a compliance officer whose responsibility is to ensure that the Market Institution

at all times complies with applicable laws, rules and regulations and submits a compliance report to the Commission periodically.

The new SEC Act has redefined “Market Intermediaries” and has included a range of new Market Intermediaries such as corporate finance advisors, derivatives brokers, derivatives dealers and market makers. The newly gazetted Rules pertain to eight Market Intermediaries. They are Investment Managers, Margin Providers, Credit Rating Agencies, Underwriters, Stock Brokers, Stock Dealers, Managing Companies and Corporate Finance Advisors. They cover the licensing procedure, minimum financial and infrastructure requirements, qualifications and experience required for persons dealing with clients, maintenance of books and records, ceasing of operations etc. Rules in respect of market makers are being prepared with the assistance of experts from the Asian Development Bank and Rules in respect of derivative brokers and dealers will be published when derivatives are to be introduced.

Similar to the provisions contained in the Rules for Market Institutions, the Rules for Market Intermediaries require them to have a compliance officer whose duties have been clearly spelt out. The key management persons are required to submit an affidavit at the time of their appointment and at the time of renewal of the license affirming compliance with the criteria stipulated for fitness and propriety.

The new SEC Act contains specific provisions for the setting up of Collective Investment Schemes (CIS) which go beyond the presently available Unit Trusts and paves the way for the introduction of Interval Funds, Exchange Traded Funds, Money Market Schemes, Umbrella Schemes, Real Estate Investment Trusts and Hedge Funds to name a few. Section 183 of the new SEC Act defines what Collective Investment Schemes are. The detailed definition makes it clear as to what type of

scheme or arrangement will be considered a Collective Investment Scheme and also explains what type of pools of funds are not included within it.

The Collective Investment Scheme Code of 2022 (the “CIS Code”) which has now been brought into force repeals and replaces the Unit Trust Code which was introduced in 2011. The CIS Code will thus provide for the creation of numerous types of collective investment schemes involving different asset classes including equity securities and fixed income securities to Real Estate, Gold, Derivatives etc. Unit Trusts will also come within this fold. They will cater to investors with diverse risk appetites. It will be possible to set up Hedge Funds although they are possible of being marketed only to Accredited Investors. The issue of high – risk instruments to the market is thereby facilitated whilst at the same time ensuring the protection of non-sophisticated investors.

The CIS Code spells out the manner of appointment and replacement of a Managing Company, its duties and functions, the manner of appointment and replacement of a Trustee and a Custodian of a scheme, their duties and functions and connected matters. It spells out in detail the types of schemes that can be set up, general conditions to be followed in their operation and marketing, general conditions for initial offers and sale and purchase of units, creation, issue, repurchase and redemption of units, sale and redemption of units in open ended and interval schemes, account keeping and reporting requirements, suspension of dealing and termination of schemes, termination or winding up of a scheme etc. The CIS Code enables the outsourcing of certain administrative functions of a Managing Company, enabling them to focus more on their core activity of investment management. It also has provisions relating to the role of an Auditor of a scheme and the co-operation that is required to be extended to an Auditor. The Annexures sets out minimum contents of a Trust Deed and the Key Investor Information

Document as well as guidance on asset valuation and pricing, guidance on conflict of interest and guidance on complaints handling.

The Chairman of the SEC Mr. Viraj Dayaratne PC commenting on the publication of the Rules said “With the coming into force of the new Act, it was necessary for us to ensure that steps are taken to give effect to the provisions contained therein and have the mechanisms in place for its proper administration. We are happy that we have been able to compile them within a relatively short period of time”. He went on to observe that “We are optimistic that these Rules will foster good business conduct and a good corporate culture among all regulated entities and provide for the fair and efficient treatment of their clients and also promote confidence in the capital market. As the Market Intermediaries are directly in contact with investors, supervision of their functions by the SEC is an important function towards preventing possible misconduct and in promoting ethical behavior. This will in turn lead to the creation of a fair and orderly market thus instilling the much needed investor confidence”.

Mr. Chinthaka Mendis, Director General of the SEC stated, “The Rules, which were finalized after several rounds of stakeholder consultations, spell out a clear framework for the operation and governance of these entities which play a pivotal role in the Capital Market. The Rules require these entities which are regulated by the SEC, to conduct themselves in a manner that will ensure the protection of the interests of their clients and preserve the integrity of the Securities Market. Compliance with these Rules is seen as an essential foundation for the maintenance of a fair and orderly market as well as to ensure investor protection”.

The Rules and the CIS Code can be accessed through the SEC Website www.sec.gov.lk.

The SEC has also finalized Guidelines to provide for the duties and obligations of ‘Supplementary Service Providers’ in terms of Section 169(3) of the Act. In terms of the definition found in Section 183, those who come within this definition are actuaries, auditors, custodians, trustees and valuers. These guidelines will be published on the Website of the SEC.

Issued by

Tushara Jayaratne

Director, External Relations and Capital Market Education



Level 28-29, East Tower, World Trade Center

Echelon Square, Colombo 01, Sri Lanka

Phone: (+94 11) 2143843 ext 190

Direct (+94 11) 2143834

Fax : (+94 11) 2439149

E-Mail: tushara@sec.gov.lk

Website: <http://www.sec.gov.lk>

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