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The Colombo Stock Exchange (Sri Lanka)

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18.1 Ownership Structure

The Colombo Stock Exchange (CSE) has a mutual ownership structure and is organized in the form of a company limited by guarantee and incorporated under the *Companies Act* of Sri Lanka and licensed by the Securities and Exchange Commission of Sri Lanka to operate as a Stock Exchange in Sri Lanka. It functions as a not-for-profit organization.

The Securities and Exchange Commission of Sri Lanka was established with the passing of the *Securities Council Act No. 36* of 1987 by Parliament. The *Act* has been since amended and today the Securities and Exchange Commission is well equipped to regulate the capital market in the country.

CSE is a member of the International Federation of Stock Exchanges (FIBV) and the South Asian Federation of Exchanges (SAFE). The stock exchange was incorporated on 2 December 1985 by seven subscribing members and since then has admitted eight more members. To date it has a membership of fifteen. CSE took over the operations of the Colombo Stock Market in 1985 from the Colombo Brokers Association (CBA) which governed the activities of the Colombo Stock Market from 1896-1985. The CBA was an association of brokers and not an incorporated body.

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18.2 Listing Data

Table 18.1. Listing Data of the Colombo Stock Exchange

ITEM	1995	1996	1997	1998	1999	2000
No. of new listings during the year	14	9	7	17	11	12
No. of new companies listed during the year	14	9	6	6	4	5
No. of listed securities as at end of the year	234	251	247	259	262	271
No. of listed companies as at end of the year	226	235	239	240	237	239
Market capitalization (Rs. Mn)	106,869	104,197	129,757	119,850	117,383	94,633

18.3 Corporate Governance

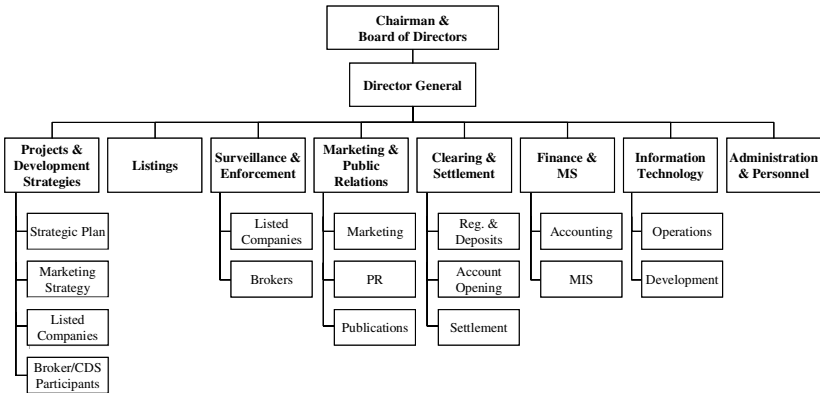
The Board of Directors is the policy making body of the CSE and consists of nine directors. Members are represented on the board of the stock exchange by five directors who are elected at the annual general meeting (AGM). The chairman of the board is elected from among the five elected directors. The chairman serves for a period of three years. An additional four directors are appointed to the board by the Minister of Finance (the Finance Ministry portfolio is held by the President of Sri Lanka). Thus, of the nine directors, five are elected by the members and four are appointed by the government.

Board meetings are held regularly. The Exchange Secretariat is headed by the Director General. The Director General participates at all board meetings and at AGMs and extraordinary general meetings (EGMs), and is accountable to the board for the operations of the CSE (Figure 18.1).

All divisional heads report directly to the Director General.

The matrix organization structure that has been adopted ensures the participation of the different divisions in formulating strategy and working towards achieving common goals and objectives. This avoids sub-optimization of objectives at the divisional level.

Figure 18.1. Organizational Chart of the Colombo Stock Exchange



18.4 Business of the Exchange

The core functions and services of the Colombo Stock Exchange (CSE) could be categorized as follows:

- listing companies to raise debt and equity capital, convertibles, warrants, asset securitizations, etc.;
- providing trading facilities for the secondary trading of all securities that are listed;
- providing on-line market data and other market related products;
- posting trade clearing, settlement, registration and depository facilities for all secondary market transactions;
- transferring of technology to other exchanges; and
- training.

The vision, mission and the corporate strategy is given below in brief. The stock exchange has developed the corporate strategy for the next three years in line with the vision and mission of CSE and with an ambition to play a more significant role in the Sri Lankan capital market.

18.5 The Vision, Mission and Corporate Strategy

The CSE shall contribute to the wealth of the nation by creating value through securities.

In particular, the mission of the stock exchange is to:

- actively pursue strategies that contribute to the growth of the capital market;
- provide facilities to trade equities, debt, derivatives and commodities futures and options;
- promote a corporate culture that encourages commitment, creativity and teamwork;
- maintain a balanced and responsive regulatory framework that will enhance market integrity and investor confidence; and
- focus on customer orientation, strive for organizational excellence and promote professionalism within the industry.

The current CSE corporate plan has organized and prioritized the development activities of the stock exchange under six key objectives:

- (i) promote new issues and new products by attracting new issues, developing the secondary market for government bonds and facilitating the risk management through the introduction of new products;
- (ii) broaden investor base concentrating on building the local institutional investor base, improving the dissemination of information and investor confidence;
- (iii) enhance the efficiency and effectiveness of the stock exchange and the Central Depository System by restructuring CSE to a more commercially focused organization;
- (iv) develop the stock broking industry by promoting the emergence of full service brokers and enhancing professionalism within the industry;

- (v) harmonize strategy with statutory and other government institutions through better interaction and coordination with related capital market institutions; and
- (vi) pursue international initiatives through alliances and other strategic linkages.

18.6 Trading Rights

Trading rights are currently given only to member firms. Trading rights are given by virtue of gaining membership in the CSE. Ownership in member firms could change subject to the approval of the CSE and the Securities and Exchange Commission, and foreign ownership of up to 100% of the equity of member firms is permitted.

18.7 Regulatory Framework

The exchange is governed by its *Memorandum and Articles of Association*. In addition, the exchange has the rules and regulations detailed (Table 18.2).

18.8 Self-Regulation

The CSE is a self-regulatory organization. In addition, the activities of the stock exchange are subject to the monitoring and supervision of the Securities and Exchange Commission of Sri Lanka.

A separate division headed by a Senior Manager is entrusted with the responsibility of market monitoring and surveillance. This includes monitoring the continuing listing requirements of listed companies, compliance by member firms of the member regulations and on line market monitoring and surveillance. The Securities and Exchange Commission similarly supervises and monitors all these activities, independent of the stock exchange.

A system of regular audits by the CSE and Securities and Exchange Commission is in place to ensure that the necessary regulations are complied with.

Table 18.2. Regulatory Framework

Listing rules

- Criteria for Admission
- Contents of a Prospectus
- Criteria for Admission
- Initial Listing Application
- Additional Listing Applications
- Contents of a Prospectus
- Memorandum and Articles of Association or other Corresponding Documents
- Trust Deeds and Debentures
- Stock Option Schemes
- Continuing Listing Requirements
- Corporate Disclosure
- Enforcement
- Fees
- Sponsors
- De-Listing of Entities

Rules governing the ATS

Rules governing the activities of the CDS

Rules governing the activities of Brokers

- Business Conduct
- Conditions of Sales (Debt, Equity)*
- Capital Requirements of a Member Firm
- Client-Broker or Inter-Broker Dispute Resolution
- Staff Trades
- Appointment of Agents
- Branch Office/Sales Outlet
- Rule for Disciplinary action against Member Firms
- Diversification of Broker Activities (Margin Lending by Member Firms, Member Firm Trading on its Own Account)

Rules governing the broker-client relationship

*The “Conditions of Sale” cover the broker client relationship. All brokers are required to follow this uniform set of rules.

The board of CSE has also set up five sub-committees to deal with administrative and regulatory aspects of the stock exchange. A representative of member (broker) directors and nonmember (broker) directors serve on these committees that are appointed by the CSE board. The committees are:

- Rules & Bylaws Committee;
- Finance, Research & Development Committee;
- Arbitration & Disciplinary Committee;
- Audit Committee; and
- Client-Broker or Inter-Broker Dispute Resolution Committee.

18.9 Statutory Regulatory Role

The Securities and Exchange Commission of Sri Lanka was established by the *Securities Council Act No. 36* of 1987 and is the government regulator for the capital market in Sri Lanka. This was one of the first Securities and Exchange Commission to be set up in the South Asian region.

The Commission was established for the following purposes:

- regulating the securities market in Sri Lanka;
- granting licenses to stock exchange, stock brokers and stock dealers who engage in the business of trading in securities; and
- setting up a compensation fund.

The objectives of the Securities and Exchange Commission of Sri Lanka are as follows:

- creating and maintaining a market in which securities can be issued and traded in an orderly and fair manner;
- protecting the interest of investors;
- operating a compensation fund to protect investors from financial

loss arising from the failure of a licensed broker or dealer to meet his contractual obligations; and

- regulating the securities market and ensuring that professional standards are maintained in such a market.

18.10 Investor Protection

One of the key objectives of the Securities and Exchange Commission is investor protection. The Securities and Exchange Commission and the CSE are committed to maintaining a fair and orderly market.

Colombo has a fair reputation internationally as a well-regulated market. investor protection operates on two tiers. Investors can lodge a complaint if they believe that they have been unfairly treated. The complaint should in the first instance be made to the Compliance Officer of the Member Firm. If the investor is dissatisfied with the decision of the member firm, the investor can refer the complaint to the Exchange and as a third recourse, he/she can refer the complaint to the Securities and Exchange Commission.

The CSE and the Securities and Exchange Commission both have surveillance divisions that track market movement to identify evidence of insider trading, front running, churning, etc. Inquiries are conducted and, if necessary, the offenders can be charged under the *Securities and Exchange Commission Act*. The market surveillance system with a database of trading records maintains details of transactions and enables investigations into market manipulations.

A settlement guarantee fund and a compensation fund are in place. Additionally stockbrokers also provide a cash deposit and a bank guarantee to the CSE to be used in the event of a settlement failure. In addition to this the brokers are also required to be sufficiently liquid and to maintain minimum levels of net capital. This minimizes the risk of a settlement failure.

18.11 Funding of the Colombo Stock Exchange

The stock exchange does not distribute profits; any operating surplus is used to develop the infrastructure of CSE and the capital markets in general. The asset position of the CSE is currently SLRs260 million (approximately US\$4.3 million).

The key sources of income are the transaction fees; annual listing fees; quotation fees payable on new listings; and membership subscriptions from broking firms.

The main items of expenditure are the establishment costs (including rent, insurance, electricity, etc.); staff costs; and information technology costs (includes the costs of depreciation maintenance and development).

18.12 Stock Exchange Seeks to Demutualize

A project team consisting of CSE and Securities and Exchange Commission officials has been appointed to study and report on the following issues:

- (i) legal issues;
- (ii) regulatory issues; and
- (iii) market aspects.

The team is currently in the process of collecting data and formulating the necessary statutory changes to the *Memorandum and Articles*, and identifying and formulating a suitable model for the CSE. It is expected that the CSE will be demutualized by 2003.

The ownership structure of CSE has not been decided upon but it is envisaged that one of the objectives of demutualizing is to broaden the base of the ownership structure.