

- (c) the continuing listing requirements or such other matters as the Commission deems fit for the purpose of subsection (1).

(5) An arrangement under subsection (3) may provide for the exchange to pay such fees to the Commission as the Commission may determine for services provided by the Commission under the arrangement or otherwise.

(6) Without prejudice to the powers of the Commission to approve or amend the rules of an exchange, the Commission may by notice in writing-

- (a) modify the listing requirements of such exchange for the purpose of applying for a listing or trading of the securities of such exchange; or
- (b) exempt such exchange from any listing requirement.

CHAPTER 2

CLEARING HOUSE

32. In this Chapter, unless the context otherwise requires – Interpretation

“central counterparty” means a legal person who engages in clearing and settlement of trades on a securities market by becoming the buyer to every seller and the seller to every buyer by guaranteeing each trade;

“default proceedings” mean any proceedings or other action taken by a licensed clearing house under its default rules;

“default rules”, in relation to a licensed clearing house, mean such rules of the licensed clearing house which provide for the initiation of default proceedings if a clearing member has failed to meet

its obligations in respect of all or any unsettled market contracts to which the clearing member is a party;

“defaulter” means a clearing member who is the subject of any default proceedings;

“market charge” means a charge, whether fixed or floating, granted in favour of a licensed clearing house -

- (a) over any property as specified in the rules of a clearing house which is held by or deposited with the licensed clearing house; and
- (b) for the purpose of securing liabilities arising directly in connection with the licensed clearing house ensuring the settlement of a market contract;

“market collateral” means any property or guarantees given in any other form of collateral as specified in the rules of a licensed clearing house held by or deposited with a licensed clearing house for the purpose of securing liabilities arising directly in connection with the clearing house ensuring the performance of market contracts by the licensed clearing house;

“market contract” means -

- (a) a contract which is subject to the rules of a licensed clearing house and entered into by the licensed clearing house with a clearing member pursuant to a novation for the purpose of clearing and settlement of transactions using the clearing facility of a licensed clearing house; or

- (b) a transaction which is or is to be cleared or settled using the clearing facility of a licensed clearing house and in accordance with the rules of the licensed clearing house, whether or not a novation referred to in paragraph (a) is to take place;

“relevant office holder” means –

- (a) any person acting in relation to a company as its liquidator, provisional liquidator, receiver or manager or an equivalent person; or
- (b) any person appointed pursuant to a bankruptcy proceedings.

33. There may be established a licensed clearing house to clear and settle securities transactions which take place in an exchange.

Establishment of a clearing house in an exchange

34. (1) A person shall not establish, operate or maintain a clearing facility for the purpose of clearing or settlement of securities transactions in a licensed exchange or with a market operator unless the person has been licensed by the Commission to establish or operate a clearing house under this Chapter.

Prohibition against establishing an unlicensed clearing facility

(2) Any person who contravenes subsection (1) commits an offence and shall, on conviction after a summary trial before a Magistrate, be liable to a fine not exceeding twenty five million rupees or to imprisonment for a term not exceeding five years or to both such fine and imprisonment.

(3) Subsection (1) shall not apply to any person providing clearing facilities for securities exempted under this Act or any clearing facility provided exclusively by the Central Bank of Sri Lanka or a clearing facility acting as an integrated central counterparty which provides for the settlement and clearing of securities as defined in this Act and securities issued by the Government of Sri Lanka or the Central Bank of Sri Lanka.

Power to grant a
licence

35. (1) The Commission may grant a licence to an applicant to establish and operate as a clearing house subject to such terms and conditions as may be specified therein.

(2) The Commission may amend, revoke or impose new terms and conditions to the licence, if the Commission is satisfied that it is appropriate to do so for the protection of investors, or for the proper regulation of a licensed clearing house.

Application for
a licence to
establish or
operate a
clearing house

36. (1) An application for a licence to establish or operate a clearing house, acting as a central counterparty or otherwise to guarantee clearing and settlement of securities transactions in a licensed exchange or a recognized market operator, shall be made to the Commission in such manner and form as may be specified by the Commission by rules and shall be accompanied by such fee as may be prescribed.

(2) An application for a licence to establish or operate a licensed clearing house shall only be made by a body corporate.

(3) An applicant shall provide all information necessary to satisfy the Commission that the applicant has established, at the time of submitting the application, the necessary arrangements to comply with the requirements of this Act, or regulation or rules made thereunder.

(4) The rules of such clearing house (hereinafter referred to as the “clearing rules”) may provide for -

- (a) the efficient provision of clearing facilities in relation to securities that are cleared through its clearing facilities;
- (b) the requirement for entering into contracts with clearing members under which they would agree to be bound by the rules of the licensed clearing house;

- (c) the admission of clearing members to the clearing house including transparent and non discriminatory criteria for such admission;
- (d) the effective regulation and supervision of its clearing members that use its clearing facilities;
- (e) conditions relating to the acceptance of guarantees or collateral, from clearing members and for the efficient management of such guarantees or collateral;
- (f) the establishment of a Settlement Guarantee Fund and the implementation of a prudent risk management system;
- (g) the obligations of clearing members and minimum requirements with regard to capital, internal audit and risk management;
- (h) the fair and efficient settlement of disputes -
 - (i) between the clearing house and its clearing members; and
 - (ii) between clearing members;
- (i) the expulsion, suspension, and disciplining of clearing members including the power or authority of the licensed clearing house to impose penalties for the failure of clearing members to comply with the rules of the licensed clearing house;
- (j) the specification of the class or the classes of securities that may be cleared and settled using its facilities;
- (k) the inclusion of default rules to facilitate—

- (i) the initiation of default proceedings if a clearing member has failed to meet its obligations under the clearing rules and the risk management procedures to deal with a clearing member who appears to be unable, or is likely to become unable to meet its obligations;
- (ii) the governing of collateral including the depositing and efficient creation and realization of guarantees or collateral provided by a defaulting clearing member in the event of default or bankruptcy of such member; and
- (iii) the uninterrupted services of the clearing house under circumstances relating to subparagraphs (i) and (ii) above or any other circumstances that threatens the solvency of a clearing house;
- (l) the time for entering settlement orders into the settlement system and the time when such orders become final and irrevocable;
- (m) the time of counterparty substitution;
- (n) the netting arrangements, the finality of settlements and any other obligations relevant to a licensed clearing house which acts as a central counterparty or otherwise.

Duties of a
clearing house

- 37.** (1) A clearing house to which a licence has been granted under section 35 shall –
- (a) operate a safe, efficient and effective clearing facility for the purposes of clearing or settlement of securities transactions;
 - (b) manage any risks associated with its business and operations prudently;

- (c) maintain an adequate level of capital in accordance with the financial risks undertaken with regard to the securities transactions that are to be cleared and settled using its services;
- (d) undertake financial liability within the limits established in its rules and within the framework of the guarantees to be taken from its clearing members in the form of margins, charges and collateral;
- (e) establish and maintain a data processing infrastructure and other internal controls including internal audit systems for risk management;
- (f) segregate the guarantees and the assets of account holders from the assets of the licensed clearing house;
- (g) not use the guarantees or assets taken from its clearing members for purposes other than those for which they were deposited; and
- (h) act in the public interest having particular regard to the need to protect investors.

(2) Notwithstanding the provisions of any other law, a director of a licensed clearing house has a duty to act at all times in the public interest having particular regard to mitigation of systemic risk and where there is a conflict between the duty under this Act and a director's duty under any other law, the duty under this Act shall prevail.

(3) A licensed clearing house shall at all times -

- (a) have robust governance arrangements, which include a clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is

or might be exposed, and adequate internal control mechanisms, including sound administrative and accounting procedures;

- (b) adopt policies and procedures which are sufficiently effective so as to ensure compliance with this Act, regulations, rules or directives made thereunder;
- (c) maintain and operate an organizational structure that ensures continuity and orderly functioning in the performance of its services and activities, and shall employ appropriate and proportionate systems, resources and procedures;
- (d) maintain a clear separation between the reporting lines for risk management and those for the other operations of the clearing house;
- (e) maintain information technology systems adequate to deal with the complexity, variety and type of services and activities performed in order to ensure high standards of security to ensure the integrity and confidentiality of the information maintained; and
- (f) make its governance arrangements, the rules governing the licensed clearing house, and its admission criteria for licensed clearing house membership, available to the public free of charge.

Commission's
power to
regulate and
supervise a
licensed
clearing house

38. Without prejudice to the generality of the powers conferred on the Commission under this Act, the Commission shall have the power to regulate and supervise a licensed clearing house in order to satisfy itself that the licensed clearing house carries on its functions in accordance with the provisions of this Act, rules made thereunder and the terms and conditions of the licensed clearing house.

- 39.** (1) The Commission may by notice in writing -
- Cancellation of
licence of a
clearing house
- (a) cancel the licence granted under section 35 to a clearing house with effect from the date specified in the notice; or
 - (b) direct the licensed clearing house to cease to provide or operate such facilities or to cease to provide such services, with effect from the date specified in the notice.

(2) The Commission shall not cancel a licence or issue a directive under subsection (1) unless the Commission is satisfied that it is appropriate to do so for the protection of investors, in the public interest or for the proper regulation of the clearing and settlement of transactions in securities, if any of the following circumstances occur:-

- (a) the licensed clearing house ceases to provide clearing facilities;
- (b) the licensed clearing house is being wound up or otherwise dissolved, whether within or outside Sri Lanka;
- (c) the licensed clearing house has contravened any term or condition of its licence or is charged with any offence under this Act;
- (d) the licensed clearing house has failed to comply with a term or condition of its license requirement or directive issued under this Act or otherwise fails to comply with any provision or requirement under this Act;
- (e) any information provided for the purposes of section 36 was false or misleading in a material particular or from which there is a material omission;

- (f) a judgment debt against the clearing house has not been satisfied in whole or in part;
- (g) a receiver, a receiver and manager, liquidator or an equivalent person has been appointed, whether within or outside Sri Lanka, in relation to or in respect of any property of the licensed clearing house;
- (h) the licensed clearing house has, whether within or outside Sri Lanka, entered into a compromise or scheme of arrangement with its creditors; or
- (i) the licensed clearing house has on its own accord applied to the Commission to cancel the licence granted to it.

(3) For the purposes of paragraph (a) of subsection (2), the clearing house shall be deemed to have ceased to provide clearing facilities if it has ceased to provide such facilities for a period exceeding two weeks without obtaining the prior written approval of the Commission to do so.

(4) Notwithstanding the cancellation of a licence or the issuance of a directive under subsection (1), the Commission may permit the clearing house to continue, on or after the date on which the cancellation or directive is to take effect, to carry on such activities affected by the cancellation or directive as the Commission may specify in the notice for the purpose of –

- (a) closing down the operations of the clearing house or ceasing to provide the services specified in the notice; or
- (b) protecting investors or the public interest.

(5) Where the Commission acts under subsection (1), the Commission may, where it considers necessary, appoint an

interim board of directors for a period of six months which may be extended up to a period of one year to manage the affairs of the licensed clearing house until a new board of directors is appointed.

(6) The Commission shall not take any action under subsection (1) without giving the clearing house an opportunity of being heard.

40. (1) A licensed clearing house which is aggrieved by the decision of the Commission made under subsection (1) of section 39, may, within fourteen days after the clearing house is notified of the decision, appeal to the Minister.

Aggrieved
clearing house
may appeal

(2) Notwithstanding the lodging of an appeal under subsection (1), any action taken by the Commission under this section shall continue to have effect pending the decision of the Minister.

(3) The Minister may, on an appeal made under subsection (1)-

- (a) allow the appeal and direct the Commission to revoke the cancellation of the licence or the directive; or
- (b) disallow the appeal.

(4) The Commission shall give effect to the decision of the Minister under subsection (3).

(5) Subject to subsection (4), the Commission shall give public notice of any cancellation of a licence or any directive issued under this section.

41. Any cancellation of a licence or the issuance of a directive under subsection (1) of section 39 shall not operate so as to –

Effect of
cancellation of a
licence to a
clearing house

- (a) avoid or affect any agreement, transaction or arrangement entered into through the licensed clearing house whether the agreement, transaction or arrangement was entered into before, or where subsection (4) of section 39 applies, after the cancellation of the licence or issuance of the directive under section 39; or
- (b) affect any right, obligation or liability arising under such agreement, transaction or arrangement.

Default rules

42. (1) A licensed clearing house shall, for the purpose of risk management, initiate default proceedings under default rules if a clearing member is unable or is likely to become unable to meet the obligations in respect of all or any unsettled market contracts to which the clearing member is a party.

(2) Where a licensed clearing house initiates any default proceedings, all subsequent proceedings or other action taken under its clearing rules for the purposes of the settlement of market contracts of which the defaulter is a party shall be deemed to have been carried out under the default rules of the licensed clearing house.

Default proceedings etc. of a clearing house to take precedence

43. (1) Notwithstanding only of an inconsistency with the provisions of any written law relating to the assets of a person subject to insolvency, bankruptcy or winding up, or on the appointment of a receiver, a receiver and a manager, a liquidator or a person in an equivalent capacity, none of the following shall be invalid to any extent in law :—

- (a) a market contract;
- (b) the rules of a clearing house relating to the settlement of a market contract;
- (c) any proceedings or other action taken under the rules of a clearing house relating to the settlement of a market contract;

- (d) a market charge;
- (e) market collateral;
- (f) the default rules of a clearing house; or
- (g) any default proceedings.

(2) Subject to subsection (1), the powers of a relevant office holder in his capacity as such and the powers of any court under the law of insolvency or the Companies Act, No.7 of 2007 shall not be exercised in such a way as to prevent or interfere with –

- (a) the settlement of a market contract in accordance with the rules of a clearing house; or
- (b) any default proceedings.

44. Nothing in the Companies Act, No. 7 of 2007 nor any other written law, shall prevent or interfere with the default proceedings instituted by a licensed clearing house in the realization and disposition of any market collateral by the licensed clearing house.

Supplementary provisions relating to default proceedings

45. (1) Upon completion of any default proceedings, a licensed clearing house shall provide a report in respect of each defaulter to the person or entity referred to in subsection (2) in respect of the following: -

Duty to report on completion of default proceedings

- (a) the net sum, if any, certified by the licensed clearing house to be payable by or to the defaulter;
- (b) the fact that no sum is so payable to the defaulter; and
- (c) such other particulars in respect of such default proceedings as it thinks fit.

(2) A certified copy of the report prepared under subsection (1) shall be provided forthwith-

- (a) to the Commission;
- (b) to the defaulter to whom the report relates or to the relevant office holder acting for the defaulter to whom the report relates or to the defaulter's estate; and
- (c) to such other person as the Commission deems fit.

(3) Where the licensed clearing house has made a report pursuant to subsection (1), relevant office holder of the defaulter shall publish a notice of that fact to bring it to the attention of creditors of the defaulter to whom the report relates.

(4) Where a relevant office holder or defaulter receives a report pursuant to subsection (1), it shall, at the request of any of his creditors-

- (a) make the report available for inspection by the creditor within two days from the receipt of such request; or
- (b) on payment of a relevant fee as determined by the relevant office holder or the defaulter, provide to the creditor a certified copy of such report or any part of that report as requested.

Net sum payable
on completion
of default
proceedings

46. (1) Upon the completion of default proceedings, the net sum certified under paragraph (a) of subsection (1) of section 45 by a licensed clearing house shall be payable by or to the defaulter.

(2) Notwithstanding any provision of the Companies Act, No. 7 of 2007, where an order for a receiver or winding up has been made or a resolution for voluntary winding up has

been passed, the net sum referred to in subsection (1) shall be taken into account in relation to winding up proceedings under the Companies Act, No. 7 of 2007.

47. (1) If a clearing member (“the first clearing member”) sells securities at an overvalue to, or purchases securities at an undervalue from, another clearing member (“the second clearing member”) in circumstances as described in subsection (3) and thereafter a relevant office holder acts for-

Right of relevant office holder to recover certain amounts arising from certain transactions

- (a) the second clearing member;
- (b) the principal of the second clearing member in the sale or purchase; or
- (c) the estate of the second clearing member or the person referred to in paragraph (b),

the relevant office holder may recover, from the first clearing member, or the principal of the first clearing member, an amount equal to the identified gain obtained by the sale or purchase by the first clearing member, or the principal of the first clearing member unless a court orders otherwise.

(2) The amount equal to the identified gain is recoverable even if the sale or purchase may have been discharged according to the rules of the clearing house and replaced by a market contract.

(3) The circumstances referred to in subsection (1) for a sale or purchase shall be where-

- (a) an identified event has occurred in relation to the second clearing member or the principal of the second clearing member; and
- (b) either-

- (i) the first clearing member knew, or could reasonably have known that an identified event was likely to occur in relation to the second clearing member or the principal of the second clearing member; or
- (ii) the principal of the first clearing member knew or could reasonably have known that an identified event was likely to occur to the second clearing member or the principal of the second clearing member, and the identified event occurs within the period of six months immediately following the date on which the sale or purchase was entered into.

(4) In this section-

- (a) “identified event”, in relation to a second clearing member or a person who is or was in respect of a sale or purchase referred to in subsection (1) means-
 - (i) an act of bankruptcy committed by the second clearing member or the principal of the second clearing member, as the case may be;
 - (ii) a meeting of creditors summoned in relation to the second clearing member or the principal of the second clearing member, as the case may be, pursuant to the Companies Act, No.7 of 2007; or
 - (iii) the presentation of a petition for the winding up of the second clearing member or the principal of the second clearing member, as the case may be, to a court;
- (b) “identified gain” in relation to a sale or purchase referred to in subsection (1), means the difference between –

- (i) the market value of the securities which is the subject of the sale or purchase; and
- (ii) the value of the consideration for the sale or purchase, as at the time the sale or purchase was entered into.

48. Notwithstanding the provisions of any other law, a clearing member who enters into any transaction including a market contract with a licensed clearing house, notwithstanding the fact that he is party to that transaction as an agent shall for all purposes including any civil action, claim or demand by or against a licensed clearing house be deemed to be a party to that transaction as a principal and not as an agent.

Clearing member to be party to certain transactions as principal

49. Notwithstanding the provisions of any other law, where market collateral is delivered in settlement of a market contract or under a market charge to a licensed clearing house by a clearing member in accordance with the rules of the licensed clearing house, no civil action, claim or demand in respect of any right, title or interest in market collateral delivered to a licensed clearing house shall be allowed against the licensed clearing house.

Market collateral delivered to a clearing house

50. The licensed clearing house shall be entitled to execute the collateral subject to a market contract or market charge in accordance with the procedure specified in the rules of a licensed clearing house.

Application of collateral subject to a market charge

51. (1) A central depository shall give effect to an instruction from a licensed clearing house to effect a transfer of securities into or out of a securities account of an account holder provided such instruction shall be for the purposes of settlement of a market contract or otherwise dealing with a market contract in accordance with the rules of the licensed clearing house.

Transfer of securities in settlement

(2) An instruction under subsection (1) shall be given by a licensed clearing house only in relation to a securities account which relates to an account holder who is a party to a market contract or an account holder who had instructed a clearing member to effect a trade which results in a market contract to which a clearing member has become a party.

(3) Where any transfer of securities pursuant to a market contract is effected by the central depository to or from a securities account of an account holder pursuant to subsection (1), no title in such securities shall pass to an account holder except as provided under the rules of a licensed clearing house.

(4) Where a transfer of securities has been effected into or out of a securities account of an account holder pursuant to subsection (1), a central depository shall not be subject to any action or claim by or be liable to any damages to that account holder.

Purchase and
sale of securities

52. (1) A licensed clearing house may require an exchange to effect on behalf of the licensed clearing house a sale or purchase of securities if such sale or purchase, as the case may be, is effected for the purposes of settlement of any market contract or to facilitate default proceedings or to enable the clearing house to realize any asset comprised in any market charge or provided as market collateral, and the exchange shall give effect to any such instruction.

(2) Where a sale or purchase of securities has been effected on behalf of the licensed clearing house pursuant to subsection (1) by an exchange, the exchange shall not be subject to any action or claim by or be liable to any damages to any person.

(3) A clearing or settlement transaction of securities carried out by a clearing house or a payment by or to a licensed clearing house shall not be reversed, undone or cancelled other than in accordance with the clearing and settlement rules of the licensed clearing house.

53. (1) It shall be a defence to a person in any civil or criminal proceedings to prove that in discharging his duties by virtue of delegation of powers under the default rules of a licensed clearing house in connection with any default proceeding in respect of anything done or omitted to be done that he exercised reasonable care and acted in good faith in the course of or in connection with the discharge or purported discharge of that duty.

Defences in
criminal or civil
liability

(2) The person referred to in subsection (1) shall include –

- (a) any member of the board of directors of the person;
and
- (b) any member of any committee established by such person.

(3) Where a relevant office holder takes action in relation to any property of any defaulter which is liable to be dealt with in accordance with the default rules of a licensed clearing house, and where the relevant office holder reasonably believes or has reasonable grounds for believing that he is entitled to take that action, the relevant office holder shall not be liable to any person for any loss or damage resulting from any action of the relevant office holder unless such loss or damage was caused by the negligence of the relevant office holder.

CHAPTER 3

CENTRAL DEPOSITORY

54. (1) A person shall not establish, operate or maintain a central depository for handling of securities, without obtaining a licence from the Commission whether such securities are listed or not listed on an exchange.

Prohibition
against
operating an
unlicensed
central
depository

(2) Any person who contravenes the provisions of subsection (1), commits an offence and shall on conviction