

**FINANCE**

**Securities and Shares, the Exchange, Brokers and Dealers**

The Securities Council Act No. 36 of 1987 which became law on August 20, 1987 has been introduced both to regularise the trading of securities in listed companies and also to encourage trading and infuse more confidence in the financial markets of the country. The government's intention is to provide private investors with the necessary investment and infrastructure facilities and incentives to undertake further investment. Furthermore, a substantial increase in the average savings rate would be required if the growth momentum of the economy is to be maintained in the face of reduced levels of capital inflow. To achieve this objective both public and private savings are being encouraged, and fiscal policies and institutional facilities that support private savings are being strengthened. It is in this context that the establishment of the Securities Council is of importance in the development and growth of business and finance in Sri Lanka; since the Act could ensure and reinforce investor confidence and promote the development of a healthy capital market. There is no doubt that the promotion of an active and orderly securities market is essential for the development of an efficient capital market. For a country like Sri Lanka, an active capital market could play a vital role in mobilising and channeling private savings into investment activities, which in turn could generate more income and employment opportunities. The legal and institutional frame work has therefore been provided in this new Act for the mobilisation of savings required for private sector growth through the share market.

The Minister of Finance in his recent Budget Speech also emphasising the need for the private sector to play a greater role, pointed out

that at present the private sector in this country was over-reliant on loans funds to finance its investment and working capital needs. The debt ratio in Sri Lankan companies was extremely high by the norms prevailing in other countries.

The records indicate that there has been a revival and development of the share market over the last ten years, compared to the previous two decades when the share market was virtually dead. The number of quoted companies has increased from 80 in 1977 to 173 by 1986; while the volume of trading in the share market per week had moved up from hardly any transactions 10 years earlier to almost Rs 10 mn per week by 1986.

The new Securities Council Act No. 36 is intended to regulate the trading of securities in listed companies, so as to ensure (1) the creation of a securities market in which they could be traded in a fair manner; (2) the regularization of the securities market to establish fair and professional standards, principles, and guidelines; and (3) the protection of the interests of the investors and their investments by operating a compensation fund.

The implicit objectives of the Securities Councils appear to have been the revamping and reviving of the securities market in the country. This is dependent, to a great extent on the building up of a high level of confidence and rapport among investors. It was expected that this move would help in channeling a substantial portion of "black money" that is available in the economy to productive investments and ventures. Consequently, an active participation of real and potential investors in the securities market could help solve the problems of the paucity of private investments in economic activities.

Thus, the whole process has been viewed to be dependent on the possibi-

lities to broadbase the public participation in investment activities, for which a set of new institutions, instruments, and guidelines need to be introduced. Amongst these institutions have been the stock exchange, stock brokers and stock dealers. The Act stipulates a comprehensive set of guidelines to regularize the operation of these instruments. They include (a) granting of licences to stock exchanges, stock dealers and stock brokers; (b) suspension or cancelling of trading activities performed by these institutions. (c) suspension or cancelling of trading activities performed by those institutions which pose threats to the interests of investors, (d) publicizing evidence against the unscrupulous activities of any such institution, (e) granting of compensation to those investors whose interests have been affected by unprofessional dealings of stock brokers and dealers.

The provisions in the Securities Council Act had distinguished the nature of functions and roles expected to be performed by the stock brokers and stock dealers. A stock broker acts as an intermediary or "middleman" between his client ( a potential investor) and a stock dealer; while a dealer specialises in trading shares in particular companies. At present there are about 10 companies performing the functions of stock brokering. This number is expected to swell with the picking up of securities market operations in the future.

A person who wishes to buy or sell securities may give instructions to a stock broker to obtain quotations for such securities. A quotation is the price at which a broker could arrange a deal, with a stock dealer. However, before finalising the transaction the stock broker could obtain further instructions from his client.

The functions of stock dealers are different. They are expected to perform a specialized function. At present there are about twenty categories of what may be called sub markets within the securities market. Share in the subset of Banks and Finance would be an

example for one such category. Stock dealers are the specialists on various aspects of trading within such sub-categories in the broader securities market. This distinction between stock brokers and stock dealers has been identified as very important by the Securities Council Act, and hence the operation of the two categories have been segregated to avoid manipulations that would endanger the interests of investors. Therefore, neither of the two categories have been allowed to obtain a licence to function both as a dealer and a broker simultaneously.

This Act emphasises the duty of the Securities Council to protect the financial interests of investors in securities. It is empowered to grant compensation to investors; and an investor who has suffered a financial loss due to a stock broker or dealer failing to meet his contractual obligations may within three months apply to the Council's Compensation Committee for compensation.

Two specific prohibitions in the Act are that a stock broker or dealer is prohibited from trading in listed securities outside the stock exchange of which he is a member; and also a stock broker or dealer is prohibited from pledging, as guarantee for the repayment of money, securities held by him on behalf of his customers, unless he obtains their written consent.

The level of penalties laid down in the Act are comparatively severe with the quantum of fines going up to Rs 10 million

The penalties (upto Rs 10 million or imprisonment or both) apply to persons contravening the provisions of the Act or any regulation made under it, or wilfully obstructing a member, officer or servant of the Securities Council in the performance of his duties. Also, a person who in connection with an application or appeal, under this Act, wilfully makes a false statement or wilfully omits a material statement and found guilty of an offence is liable on conviction to a fine upto Rs 1 million.

U.V.