<u>CORPORATE FINANCE – LEGISLATION GUIDE SRI LANKA IFLR1000 (2007 edition)</u>

Whilst legislation relating to Sri Lanka's financial arena per se has not changed significantly over the past year, recent legislative developments and case law will undoubtedly impact on the activities of corporates and the financial sector, in particular.

Convention of the Suppression of Terrorist Financing Act No. 25 of 2005

Sri Lanka, which was already a signatory to the International Convention on the Suppression of Terrorist Financing adopted by the General Assembly of the United Nations, joined the global effort to combat money laundering and the financing of terrorism by enacting the Convention of the Suppression of Terrorist Financing Act No. 25 of 2005 (CSTFA) in mid 2005.

Prevention of Money Laundering Act No. 5 of 2006

In January 2006, the Sri Lankan Parliament enacted the Prevention of Money Laundering Act No 5 of 2006 (PMLA), whereby the act of money laundering, as well as attempting to and aiding and abetting money laundering are criminal and extraditable offences. The offence of money laundering is defined as – receiving, possessing, concealing, investing, disposing of, bringing into Sri Lanka, transferring out of Sri Lanka or engaging in any other manner in any transaction in relation to any property derived or realized directly or indirectly from "unlawful activity" or from the proceeds thereof, knowing or having reason to believe such is the case. "Unlawful activity" is defined to include offences under statues/laws dealing with drug and arms trafficking, bribery, exchange control, terrorism, transnational organized crime, cyber crime, trafficking of persons, etc. The PMLA also provides for mechanisms to enable the tracking, freezing and confiscation of tainted assets.

Financial Transactions Reporting Act No. 6 of 2006

The Financial Transactions Reporting Act No. 6 of 2006 (FTRA) was enacted to support the investigation and prosecution of offences under the CSTFA and PMLA. Under this law, a new regulatory authority – the Financial Intelligence Unit (FIU) was set up to collect, analyze and disseminate information pertaining to possible instances of money laundering required for enforcement purposes, monitor suspect financial transactions and conduct investigations thereon. This law also provides for co-operation between other regulatory authorities and the FIU both locally and internationally.

The new law requires financial institutions to identify their customers when they enter into business relationships or conduct transactions and to maintain records of customer identification and transactions together with related documents for a period of 6 years. They are also required to conduct ongoing due diligence on customers and to report cash transactions and electronic fund transfers above a specified limit as well as any suspicious transactions to the FIU. This places a significant responsibility on the financial sector and Bankers have already expressed concern on being called upon to do a policing job.

The aforesaid obligations also apply to designated non-financial businesses and professions, including lawyers and accountants. However, a lawyer need not disclose any privileged communication of a confidential nature between a lawyer and a client or between two lawyers for the purpose of obtaining legal advice or assistance, provided the communication was not made for the purpose of committing or furthering the commission of some illegal or unlawful act.

It is yet to be seen whether the implementation of the anti-money laundering legislation would lead to a substantial increase in the cost of financial products and servicing of financial transactions.

Stamp Duty (Special Provisions) Act No. 12 of 2006

Stamp Duty on various transactions such as share transfers or assignments, share issues, mortgages, promissory notes, receipts, lease/hire agreements, etc, which had previously been abolished in 2002 was re-introduced with effect from 4 April 2006. Stamp Duty is also applicable to a range of services such as purchases on credit cards (one percent or Rs 10 for every Rs1000 spent on a credit card transaction) leasing and insurance policies. Stamp Duty is not payable on certain specified documents and instruments such as the issue and transfer of shares of public quoted companies, mortgages of food crops, mortgages relating to aircrafts, finance leases (except for motor vehicles used for traveling), etc. The existing Stamp Duty rate applicable to immovable property continues unchanged.

Electronic Transactions Act

A significant and welcome piece of legislation necessary for the overall development of Information and Communication Technology, electronic commerce and e-government activities is the Electronic Transactions Act enacted in March 2006 based on the relevant UNCITRAL Model Laws. This Act covers a wide range of issues including legal recognition of electronic documents in the form of data messages and other communications, acceptance of electronic documents in place of documents required in writing, legal recognition of electronic signatures, use of electronic records and electronic signatures in Government and statutory bodies, retention of electronic records and legal acceptance of electronic contracts. The applicability of the Act does not extend to, *inter alia*, execution of a Will, a Bill of Exchange, a Power of Attorney, a Trust, and a contract for sale or conveyance of immovable property or any interest in such property.

Case Law

In April 2005, in the landmark case of *Ramachandran & another v. V. Anandasiva and 12 others*, the Supreme Court took the view that a mortgaged property which belonged to a guarantor or to another third party other than the borrower cannot be subject to parate execution (i.e. a procedure which enables banks to recover bad debts by auctioning the mortgaged property without instituting court action). This decision dealt a severe blow to the debt recovery process of banks since parate actions considerably reduced the time and costs involved.

Draft Legislation

A piece of legislation in the making for nearly a decade is the draft Companies Bill (intended to replace Sri Lanka's present Companies Act passed in 1982), which is due to be presented to Parliament within the next few months. The Bill aims to modernize and simplify the incorporation process and the operation of Sri Lankan companies by *inter alia*, by doing away with the memorandum and articles (if the company so decides), removing the concept of par value for shares, permitting single shareholder companies and allowing corporates to manage their own financial structures by permitting companies to buy back their own shares. The Bill also introduces minority buy-out rights and the establishment of a Companies Dispute Board.

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