

Retail investment funds in Armenia: regulatory overview

Narine Beglaryan
Concern Dialog law firm

global.practicallaw.com/w-014-6327

MARKET OVERVIEW

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Open-ended retail funds

The Law of Armenia on Investment Funds (Investment Funds Law) was adopted on 22 December 2010 and has been in effect since 9 January 2011.

The Investment Funds Law allows for the establishment of both open-ended and closed-ended retail funds in Armenia. However, the Armenian investment fund market is still growing, and the number of investment funds established only began to increase in 2017 (with more than half of Armenian investment funds registered in 2017).

According to data published on the website of the Central Bank of Armenia (CBA), the number of registered investment funds (other than pension funds) is 16. According to the CBA's website, the number of open-ended funds established in Armenia is three out of 16 (two of these are specialised investment funds and one is a standard investment fund).

It should, however, be noted that Armenian legislation does not define retail funds or use the term "retail fund" as such.

Closed-ended retail funds

According to the CBA's website, ten investment funds (other than pension funds) have been indicated as closed-ended funds established in Armenia. Of these, five have been presented as specialised funds.

REGULATORY FRAMEWORK AND BODIES

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

Open-ended retail funds

Regulatory framework. The main law regulating investment funds is the Investment Funds Law, which allows for the establishment of open-ended and closed-ended retail funds in Armenia.

The following other regulations govern retail funds in Armenia:

- Regulation 8/03 on Information Publication by Banks, Credit Organizations, Insurance Companies, Insurance Brokers, Investment Companies, Central Depository and Payment and Settlement Organizations Implementing Money Remittances.

- Regulation 10/01 on Registration and Licensing of Investment Fund Managers and Branches of Foreign Investment Fund Manager; Registration of Branches of Investment Fund Manager and Representative Offices of Investment Fund Manager and Foreign Investment Fund Manager; Re-Registration and Re-Licensing of Investment Companies as Investment Fund Managers; Acquisition of Qualified Holding in Statutory Fund of Investment Fund Manager; Procedure, Forms and Periods of Submission of Work plans, Reports on their Amendments and Execution by Investment Fund Managers, their Branches and Branches of Foreign Investment Fund Manager.
- Regulation 10/02 on Prudential Standards of Management Company, Sizes Thereof (Including Minimum Size of Mandatory Holding of Management Company in Each Investment Fund under Management of Management Company), Minimum Size of Infringement of Prudential Standards which are Grounds for Revocation of License (Permission) of Management Company.
- Regulation 10/04 on the Procedure of Calculation of Net Asset Value of Investment Funds.
- Regulation 10/05 on Accreditation of Managers of Investment fund Managers and Custodians, Natural Persons Executing Investment Fund Management Activity and Investment Fund Custody Keeping, Criteria For Their Professional Compliance and List of Topics for Assessing their professional qualification.
- Regulation 10/10 on Investment Limits of Investment Funds.
- Regulation 10/11 on Terms and Conditions for Registration of Investment Fund (Fund Rules), Issuing Permission to Sell Securities of Foreign Investment Fund in the Republic of Armenia.
- Regulation 10/14 on Procedure of Calculation of Net Asset Value for Determining Taxable Profit.

Regulatory bodies. The Central Bank of Armenia (CBA) is the main regulatory body for both the investment funds market and the securities market in Armenia.

Closed-ended retail funds

Regulatory framework. The regulatory framework for closed-ended retail funds is the same as for open-ended retail funds, and laws applicable to open-ended funds also apply to closed ended funds (see above, *Open-ended retail funds*).

Regulatory bodies. The CBA is the main regulatory body for both the investment funds market and the securities market in Armenia.

3. Do retail funds themselves have to be authorised or licensed?

Open-ended retail funds

A fund is deemed founded from the moment the Central Bank of Armenia (CBA) either:

- Registers the fund, in the case of a corporate fund.
- Registers the fund's rules (that is, the fund's regulations) in the case of a contractual fund.

No other authorisation or licence is required to act as a fund (including retail funds).

To register the fund, the fund's founder or manager (or in the case of a contractual fund, the manager) must submit the following documents to the CBA:

- Application for registering the fund (or fund's rules) and its firm name.
- Decision of the founder (founders' meeting) on founding a fund (in the case of a corporate fund).
- Decision from the fund manager's board of directors (board) to found and manage the fund (not applicable if a corporate fund is being founded, which is not on the initiative of the manager).
- Six copies of the draft of the fund's rules or charter.
- Fund manager's board decision to approve the fund's rules (in the case of a contractual fund).
- Draft of the fund management contract that is presented by the manager and approved at the founders' meeting.
- Draft of the fund custody contract entered into by the manager and the custodian (in the case of a contractual fund) or the fund's custody contract presented by the custodian and approved (in the case of a corporate fund) at the founders' meeting.
- The decision of the founder (founders' meeting) (in the case of a corporate fund) or the fund's meeting (in the case of a contractual fund, whose rules do not envisage that in that fund a fund meeting will not be called) to approve the fund's rules and draft custodian contracts.
- Payment slip for the state duty.
- Other documents as stipulated by the CBA's regulations (if any).

For open-end funds (including retail funds), there is no specific requirement to submit a prospectus to the CBA for registration.

To sell foreign fund securities in Armenia, the foreign fund or its manager must submit an application to and acquire preliminary authorisation from the CBA (although applicants are not required to submit a prospectus as part of their application).

For open-ended funds, the fund's rules will be considered to be a prospectus, and the requirement to provide one under the Law of Armenia On Securities Market will not apply.

Closed-ended retail funds

As with open-ended funds, closed-ended funds are the subject to registration with the CBA (*see above, Open-ended retail funds*).

The process for application is the same as for open-ended retail funds (both for registration of the fund and the requirement for a foreign fund to receive preliminary authorisation before selling its securities in Armenia), except for the prospectus requirement, which should also be submitted for closed-ended funds.

In addition, unlike open-ended funds, close-end funds' investor records (including retail funds) must be surrendered to and registered with the Central Depository.

MARKETING

4. Who can market retail funds?

Open-ended retail funds

Management of a fund can include the management of investments, which includes the organisation of offerings and underwritings of the fund's shares (marketing)) (for details of a fund manager's functions, see *Question 6*). The marketing of a fund is therefore carried out by the fund manager.

In relation to the marketing of retail funds in Armenia, it should be noted that any advertisement, announcement about any type of fund or any action directed towards the offer and/or sale of a fund's shares, document or means of communicating information relating to the fund must include a clearly visible statement, that is separate from the other information, stating that the fund and its manager cannot guarantee the fulfilment of purposes declared by the fund.

When making any such marketing announcement, the fund manager is prohibited from:

- Making any misleading assumptions and statements in relation to the fund.
- Giving guaranties in relation to the fund.
- Making any unjustified/misleading promises in relation to the fund.
- Using unfair competition methods.

Closed-ended retail funds

The same rules on marketing requirements for open-ended retail funds apply to closed-ended retail funds (*see above, Open-ended retail funds*).

5. To whom can retail funds be marketed?

Open-ended retail funds

For both open-ended and closed ended retail funds, the following persons cannot be shareholders (investors) in the fund:

- The fund custodian.
- The fund registrar (if this function is carried out by a person other than the fund manager).
- The independent auditor of the fund.
- Any persons affiliated with those listed above.

Under Armenian legislation, two or more persons will be considered affiliated where any of the following scenarios are applicable:

- Where one directly or indirectly owns, by the virtue of voting right, 20% or more of equity securities carrying voting rights of the other (or others).
- Where more half of the members of the board of directors of either entity, director or other related official with such competencies, is also at the same time a member of the board of directors of the other entity (or others), or a director or other related official for the other (or others) with such competencies.

- Where one of them is the subsidiary of the other, or where they are under common supervision (for example, where they are both subsidiaries of the same parent company), or where one of them, in accordance with criteria set out by regulatory legal acts of the Central Bank of Armenia (CBA), has an actual opportunity or opportunity prescribed by a contract to essentially influence the decisions of the other.
- Where they are members of the same family (the father, the mother, the spouse, parents-in-law, the grandmother, the grandfather, sister, brother, children, sister's and brother's spouses and children) or where they have been acting in concert in a given situation, for a common economic interest.

The shares of an open-end fund must be issued continuously, ensuring their everyday supply in the primary market. The value of the shares of an open-end fund must not be fixed.

The shareholder does not have a preference right on newly-issued shares.

In relation to the marketing of local retail funds, the local retail fund must be registered by the CBA. For foreign retail funds, preliminary authorisation from the CBA is required for them to be marketed locally.

Closed-ended retail funds

In addition to the regulations applicable to open-ended retail funds which also apply to closed-ended retail funds (*see above, Open-ended retail funds*), there are a few additional requirements for closed-ended retail funds, namely:

- The rules of the closed-end fund cannot limit the right of shareholders to sell their shares in regulated markets.
- The shares of the closed-end fund are subject to mandatory authorisation for sale in the regulated market.

MANAGERS AND OPERATORS

6. What are the key requirements that apply to managers or operators of retail funds?

Open-ended retail funds

For both open-ended and closed-ended retail funds, there is no specific rule in Armenia which limits or lists the persons that are entitled to establish retail funds (*see Question 3*).

Management of the fund (whether open or closed-ended) must be provided by a fund manager. A fund can have only one manager, but manager can manage more than one fund (however, contractual funds managed by the same manager can differ with regards to type, investment policies, rights certified by the shares of participants and/or limitations on the circle of fund's participants).

A fund acting in Armenia can be managed by a local manager (a joint stock company or limited liability company established in Armenia), a local subsidiary of a foreign manager, or by local branch of foreign manager.

Management of a fund can include the management of investments, which generally implies:

- The adoption and execution of decisions concerning the investment of the fund's assets within the investment policy of the fund.
- The organisation of the issuance and repurchase (redemption) of shares.
- The organisation of legal and accounting functions in connection with the management of the fund.

- The organisation of offerings and underwritings of shares (marketing).

To act as a fund manager, a local company or subsidiary/branch of foreign manager should be registered and licensed by the Central Bank of Armenia (CBA).

The business activities of fund managers are limited: any activities other than the managing of fund should only relate to the securities market and can only be implemented subject to the CBA's permission.

The fund manager should comply with requirements in relation to (among other things):

- Its qualified and certified top management.
- Minimal amount of charter capital (that is, capital the founders put into the fund when first established) and total capital.
- Its reporting obligations to the CBA.
- Its business plan for each three-year period.
- The establishment of an internal board and systems of internal control.
- Participation rate in managed funds.

The fund manager should register any of the following changes to the CBA:

- Any change to the charter of subsidiary/branch of foreign manager or manager.
- Any change to its top management.

To ensure more efficient management, the manager can outsource certain functions to a third party if this is envisaged in the fund's rules.

It should be noted that there are a few minor differences in relation to the decision-making procedures for open-ended contractual funds (for example, where prior approval for a general meeting may be required).

Closed-ended retail funds

The regulation for closed-ended retail funds is generally the same as for the open-ended funds (*see above, Open-ended retail funds*).

ASSETS PORTFOLIO

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

The assets of the fund must be transferred to a custodian under a custody contract. A custodian can be the Central Depository or a bank operating in the territory of Armenia, which pursuant to the Law of Armenia On Securities Market (Securities Law) provides securities custody services. Custody of assets of a single fund can only be taken by a single custodian, personally or through sub-custodian (sub-custodians).

Generally, the custodian deposits, keeps safe and records the fund's assets, services the transactions conducted on behalf of the fund, and (subject to these) transfers the assets.

For the protection of the assets, the Investment Funds Law sets out the following rules in relation to the custodian:

- The custodian must not be affiliated with the fund manager. During the period of the custody contract, the manager and the custodian should take reasonable measures to prevent circumstances leading to affiliation between themselves, and if such circumstances arise, deal with them within six months.

- If the custodian finds any violation of the requirements of the law, regulations and/or the fund's rules while implementing its responsibilities, it must inform the Central Bank of Armenia and the fund manager of the violation in writing within one working day.
- The custodian must take responsibility for causing any damage (including lost income) to the manager or fund or to the shareholders of fund that had resulted from its actions or inaction (unless it can prove that it acted within its fiduciary duties). Meanwhile, the fund manager can directly or indirectly bring a claim for remedying the damages caused to the fund or its shareholders.
- When carrying out its obligations, the custodian must act in accordance with the interests of fund's shareholders, and should implement its rights and fulfil its obligations towards the fund's shareholders in good faith and reasonably and adequate level of professionalism (fiduciary duty).
- The contract signed between the fund (or fund manager of a contractual fund) and the custodian must not limit the responsibilities of the manager set out in the Investment Funds Law and/or other laws.

Closed-ended retail funds

Assets of closed-ended retail funds transferred to a custodian under a custody contract are generally subject to the same rules as for retail investment funds (see above, *Open-ended retail funds*).

LEGAL FUND VEHICLES

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

Open-ended retail funds

Legal vehicles. Open-ended funds can be contractual funds or joint stock companies with a floating capital.

Advantages. Contractual funds and joint stock companies with floating capital are obliged to repurchase their issued securities from their shareholders during any given business day if requested by such shareholder. Therefore, on each business day, the manager of the fund will calculate and publish the calculating value, as well as the underwriting and redeeming prices of the shares of the open-ended fund that it manages.

Disadvantages. Some disadvantages of open-ended funds are as follows:

- The number and value, as well as the nominal value of the shares of open-ended funds cannot be fixed.
- The open-ended fund structure cannot be established as joint stock company with fixed capital.
- There is no general meeting requirement (or requirement for such meeting to be authorised) set by law for open-ended contractual funds (that is, for closed-end corporate funds (joint stock company with a floating capital), a general meeting is required).

Closed-ended retail funds

Legal vehicles. Closed-ended funds can only be contractual funds or joint stock companies with fixed or floating capital.

Advantages. The main advantages to closed-ended retail funds are as follows:

- The shares of closed-ended funds are subject to mandatory authorisation when trading on a regulated market. Therefore, the operator of the regulated market, currently Nasdaq OMX Armenia OJSC, cannot prevent the shares from being traded.

- Closed-ended funds can be formed as joint stock company with the fixed capital.
- The shares of the closed-ended funds should have nominal value.
- There should be a general meeting (except for closed-ended contractual funds, where the rules provide that no general meeting should be convened).

Disadvantages. The shareholders of closed-ended funds are generally not entitled to demand for a repurchase of their shares, except where this is explicitly stipulated by law.

INVESTMENT AND BORROWING RESTRICTIONS

9. What are the investment and borrowing restrictions on retail funds?

Open-ended retail funds

For open-ended retail funds, the fund's assets cannot be formed through debt, unless both:

- The amount of the debt does not exceed of the 10% of the fund's assets, for which the debt is being taken.
- The debt is either for a short-term (not exceeding three months) or for the purpose of acquiring property directly necessary for the corporate fund's operations.

The fund's assets cannot be formed through the sale of securities or other financial instruments, which the fund does not possess at the time of the transaction (short sale).

In accordance with the general rule, assets of the fund cannot be subject to loans, guarantees or assurances. The fund's assets cannot be collateralised or security the fulfilment of obligation of others.

The Investment Funds Law sets out a list of assets to which a standard funds' assets (including retail funds) can be invested, which are as follows:

- Securities listed by the Central Bank of Armenia and permitted for trading on the regulated market of Armenia.
- Securities allowed for trading in foreign regulated markets if those markets are open to the public, operate on a regular basis, and are so permitted in the rules of the fund.
- Newly-issued securities, according to the issuing and/or offering conditions of which are allowed in a regulated market during the 12 months after their issuance.
- Money market instruments if they are either:
 - securities issued or guaranteed by the state of Armenia, the CBA, the municipalities of Armenia, as well as any international organisation or foreign country, central bank or local government included in the list established by the CBA; or
 - securities of an issuer authorised to trade in regulated markets issued or guaranteed by an organisation that complies with the requirements prescribed by the CBA's regulations.
- A demand or time deposit, with a maturity of more than one year in banks operating in Armenia or foreign banks that comply with the requirements of the CBA's regulations.
- Derivative financial instruments that are permitted for trading in regulated markets.

- Derivative financial instruments that are being traded outside of the regulated market which:
 - have their object as being securities, bank deposits, fund's shares, exchange indexes, interest rates, foreign currency exchange rates or currency in which the fund, in accordance with its fund's rules can make investments;
 - are part of transactions entered into by an entity that is subject to financial supervision, and whose value can be reliably and dependably estimated each day; and
 - can be sold at any moment by the initiative of the fund at a fair price (closing of the position through offset transaction).
- Other liquid assets, envisaged by CBA.
- Securities that are not listed above, provided the total value of the fund's assets does not exceed 10%.

The assets of an open-ended fund cannot be invested in precious metals, or in securities or derivative financial instruments that provide purchasing rights for such metals.

Investing the fund's assets into the securities or other assets of the fund's manager, custodian or custodian's management, the shareholders' record keeper and/or external auditor, or any person affiliated with such persons on a regulated market, without the prior consent of the CBA, is prohibited.

Closed-ended retail funds

The regulation for closed-ended retail funds is generally the same as for open-ended retail funds (see above, *Open-ended retail funds*) except for investments into precious metals (that is, closed-ended funds are permitted to invest into precious metals, securities and derivatives authorising to purchase of such metals).

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

The fund manager cannot place any restrictions on the issue and redemption of share interests in an open-ended fund.

According to rules established by the Central Bank of Armenia (CBA), the manager of an open-ended retail fund can suspend the redemption of shares for no more than for three months if prior notification has been made to both the CBA and to the fund's custodian, and where he/she is so entitled under the fund's rules. However, the CBA can request the fund manager to resume redemption on its own initiative if the reasons for suspending redemption no longer exist. The CBA may also instruct the manager of a corporate fund to suspend the issuance, placement and repurchase of the shares until the grounds for suspension have been remedied.

Closed-ended retail funds

The rules for closed-ended retail funds are substantially similar to those of regulated open-ended retail funds (see above, *Open-ended retail funds*).

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

Open-ended retail funds

In open-ended retail funds, there are no restrictions on the shareholders' right to transfer or assign their interests to third parties.

Closed-ended retail funds

In closed-ended retail funds, there are no restrictions on the shareholders' right to transfer or assign their interests to third parties.

REPORTING REQUIREMENTS

12. What are the general periodic reporting requirements for retail funds?

Open-ended retail funds

Investors. On request (no specific period is determined) the fund manager must provide the fund's shareholders with any information subject to publication (for example, the fund's last annual report and the auditor's conclusion about it, as well as the prospectus (rules) in relation to the fund. The fund manager should also publish the defined list of information on its website.

Regulators. The manager of open-ended and closed-ended funds should, for each fund that he/she manages, prepare, publish and submit complete and accurate financial and other reports (on an annual and intermediate basis) to the CBA in the form and with the content so required by the CBA.

Closed-ended retail funds

The rules are the same for both open-ended and closed-ended funds (see above, *Open-ended retail funds*).

TAX TREATMENT

13. What is the tax treatment for retail funds?

The tax regulations for investment funds and investments set out general rules applicable to both open-ended and closed-ended retail funds.

Funds

According to Armenian tax law, the seat of an investment fund established in Armenia will be the seat of its fund manager. For all matters in relation to the payment of taxes, the fund manager acts on behalf and on account of the investment fund that he/she manages.

Investment funds are subject to income tax. The tax base for the calculation of income tax is the total amount of the fund's net assets established in Armenia calculated according to rules established by the Armenian tax authorities and the Central Bank of Armenia (CBA) (no deductions from the sum distributed to shareholders as dividends are permitted while determining the tax base). The income tax rate for investment funds is 0.01% from its tax base.

The following transactions are not subject to VAT:

- The provision of services for the allocation and/or buyback (redemption) of securities issued by investment funds.
- The provision of investment fund custody services.
- The disposal (sale) of real estate to the shareholders of a fund where that investor had invested in exchange for shares in fund.

It is prohibited to make a loan of either the accounts or cash of the fund.

Resident investors

Investment from a natural person into a fund, along with the profit received from the sale of securities that make up a fund, will not be considered a disposal subject to the calculation of profit tax.

Expenses related to the purchase, sale or other activities related to the shares of funds are not considered expenses for the calculation of income tax base for legal entities. In addition, income received from securities of funds are not considered income.

Non-resident investors

No tax is applicable to non-resident investors in Armenia.

QUASI-RETAIL FUNDS

14. Is there a market for quasi-retail funds in your jurisdiction?

There is no quasi-retail-funds market in Armenia.

REFORM

15. What proposals (if any) are there for the reform of retail fund regulation?

To the best of our knowledge, there is no proposed or upcoming draft or legal amendment due in relation to retail investment funds.

The recent amendments to the Investment Funds Law, which passed their first reading at the National Assembly of Armenia, were related to securitisation funds only.

ONLINE RESOURCES

Armenian Legal Information System

W www.arlis.am

Description. The Armenian Legal Information System website contains Armenian legislation. It is updated and supported by the Public Bulletin CJSC. No translations of laws and regulations are available.

Central Bank of Armenia

W www.cba.am

Description. Provides categorised laws and regulations as well as translations for them (it should be noted that not all of them are up-to-date).

Practical Law Contributor profile

Narine Beglaryan, Partner

Concern Dialog law firm

T +374 99 353452

F +374 60278888

E narine.beglaryan@dialog.am

W www.dialog.am

Professional qualifications. Republic of Armenia, Attorney, 2007

Areas of practice. Banking; capital markets; anti-money laundering/terrorist financing.

Languages. Armenian, Russian, English

Professional associations/memberships. Chamber of the Advocates of the Republic of Armenia (since 2012).

Publications

- *Authored the article "Warranty: a Rescue or a Trap?" published in AmCham Business Magazine Spring-summer 2014.*
- *Analysis of the Company Law published in International Trust Laws and Analysis, Supplement 2018-1.*
- *Doing Business in Armenia published in Practical Law Global Guide 2016/17.*
- *Mergers and Acquisitions 2016 published in ICLG.*
- *Litigation and Dispute Resolution 2017 published in Global Legal Insights.*
- *Armenia - Data Protection in the Financial Sector Guidance Note as an expert contributor to Data Guidance, the global privacy platform in 2017.*