



**USAID**  
FROM THE AMERICAN PEOPLE



**Business Plus Initiative**  
USAID funded project implemented by Chemonics International

# Law on Investment Funds

July 2012  
Ulaanbaatar, Mongolia



Project: Mongolia Business Plus Initiative Project (BPI)  
Report Title: *Law on Investment Funds*  
Main Author: Henry N. Schiffman  
Contract No. 438-C-11-00001  
Submitted by: BPI Project/Chemonics International Inc., Express Tower, 12<sup>th</sup> Floor,  
Chingeltei District, Ulaanbaatar, Mongolia  
Telephone and fax: (976-11) 32 13 75 Fax: (976-11) 32 78 25  
Contact: Efrain Laureano, Chief of Party  
E-mail address: [elaureano@bpi-chemonics.biz](mailto:elaureano@bpi-chemonics.biz)



## **ABBREVIATIONS AND ACRONYMS**

---

BPI	Business Plus Initiative Project
FRC	Financial Regulatory Commission
IOSCO	International Organization of Securities Commissions
MSE	Mongolian Stock Exchange
UCITC	Undertaking for Collective Investment in Transferable Securities
USAID	United States Agency for International Development



## TABLE OF CONTENT

---

ABBREVIATIONS AND ACRONYMS .....	i
EXECUTIVE SUMMARY.....	i
SECTION I: GENERAL PROVISIONS .....	1
SECTION II: INVESTMENT FUND ORGANIZATION, MANAGEMENT AND GOVERNANCE .....	3
SECTION III: INVESTMENT FUND OPERATIONS .....	5
SECTION IV: PROHIBITIONS ON PRACTICES WITH RESPECT TO INVESTMENT FUNDS .....	9
SECTION V: ENFORCEMENT REGARDING VIOLATIONS OF LAW .....	11
SECTION VI: MISCELLANEOUS PROVISIONS.....	13
ANNEX A: LAWS ON INVESTMENT FUNDS .....	17
Section I. General Provisions .....	17
Article 1. Scope of Application of the Law; Regulation and Supervision.....	17
Article 2. Definitions.....	17
Section II. Investment Fund Organization, Management and Governance .....	19
Article 3. Investment Fund Sponsors.....	19
Article 4. Investment Fund Licensing; Involuntary Liquidation.....	19
Article 5. Investment Fund Organization.....	20
Article 6. Investment Fund Governance.....	21
Article 7. Investment Fund Trustees' Qualifications .....	21
Section III. Investment Fund Operations .....	21
Article 8. Investment Fund Portfolio Management .....	21
Article 9. Investment Fund Unit Initial Distribution and Subsequent Sales .....	22
Article 10. Offering Material Misstatements and Omissions.....	22
Article 11. Duties of an Investment Fund Sponsor .....	22
Article 12. Custody of Investment Fund Assets; Account Statements .....	23
Article 13. Duties of an Investment Fund Custodian .....	24
Article 14. Conduct of Business Rules for Investment Funds.....	24
Article 15. Prohibited Transactions with respect to an Investment Fund .....	25
Section IV. Prohibitions on Practices with respect to Investment Funds .....	26
Article 16. Misuse of Information, Fraud; Insider Trading; Material Misstatements .....	26
Article 18. Falsification of Accounting, Financial Records, Filings.....	27
Section V. Enforcement regarding Violations of Law .....	27
Article 19. Investigations .....	27
Article 20. Remedial Measures and Penalties for Civil Infractions .....	28
Article 21. Criminal Offenses .....	29
Section VI. Miscellaneous Provisions.....	29
Article 22. Segregation of Investment Fund's and Investment Fund's Investors' Assets ....	29
Article 23. Regulatory Determinations .....	29
Article 24. Private Right of Action .....	30
Article 25. Imputed Liability.....	30
Article 26. Resolution of an Investment Fund Insolvency.....	30
Article 27. Evidence.....	31
Article 28. Interpretation .....	31



## **EXECUTIVE SUMMARY**

---

### **Introduction**

Investment funds provide a means for investors to aggregate their savings of relatively small sums of money for investment by professional asset managers. In countries with developed financial markets, there are usually hundreds if not thousands of investment funds. This may be the best way for ordinary individuals who are not financial and securities market experts to invest their savings in the capital markets and participate in Mongolia's economic growth. For intelligent investment in some securities, minimum amounts must be invested which are larger than ordinary individuals could invest or should invest to be able to diversify their investments in different asset classes which is a fundamental principle of investments in securities.

### **Proper meaning of investment fund**

Investment funds in the draft Law on Investment Funds (the "Law") are retail funds or public funds, like those covered in the EU directive on Undertakings for Collective Investment in Transferable Securities (UCITS). Investment in such funds is different from "alternative investments." Alternative investments include private equity, venture capital, hedge funds and REITs.

For the protection of retail investors, investment in retail funds has legal requirements for fund governance, qualifications of fund administrators, diversification of fund assets, regulation and supervision. Critically important, the eligible assets for investment are predominantly debt or equity securities listed on a securities exchange. This is so that investors are able to sell their investments without suffering losses due to possible volatile price movements or no active market that can occur with illiquid investments. The law recommended requires that an investment fund must invest 90 percent of its assets in exchange-traded securities. This is the same model for eligible assets as the EU Directive on UCITS that is applicable to 27 countries.

Alternative investments are, for the protection of unsophisticated investors, only eligible to institutional investors—pension funds, insurance companies, foundation endowments—and very wealthy individuals, because either the law so requires or because of the minimum investments required, often USD 5 million or more. Such investments tend to have higher risk as well as the promise of higher returns. Indeed, in the past two years some 2000 hedge funds have closed because of poor performance or losses.

It makes no sense to have a law for both investment funds, as commonly understood in countries with developed financial markets, and alternative investments, as commonly understood in countries with developed financial markets. The two types of investments are totally different with respect to: eligible investors; eligible assets for investment; and requirements (for investment funds) and no requirements (for alternative investments) with respect to: governance; diversification of assets; reporting; and regulation. Thus a separate law for alternative investments could be enacted. However, there are also the important issues of regulatory cost to taxpayers and regulates and the limited capacity of the FRC and dilution of FRC resources in registration or supervision of alternative investments whose investors can protect themselves.

### **Taxation considerations**

To promote investment funds, an important complement to a law on investment funds is that the tax law should provide that investment funds are "transparent" or "pass through" for tax purposes. That is, either investment funds are not subject to income tax but investors in the fund are subject to tax on income and capital gains from investment funds, or, if funds are

subject to tax on their income and capital gains, funds are entitled to a deduction for the amounts distributed to their investors. Whether or not there is an income tax, consideration should also be given to what, if any, tax consequences exist for an investment fund or its investors under any value-added tax or other tax requirement and what, if any, relief therefore should be granted to encourage investment in investment funds.

There are eight key areas for an investment fund law:

- Eligible sponsors
- Legal form of funds
- Segregation of investment fund and investors' assets from sponsors' and portfolio managers' assets
- Conduct of business rules for transparency and fair treatment of investors
- Disclosure of financial and operations information to investors
- Eligible assets for investment fund investment
- Rules to prevent exploitation of conflicts of interest by sponsors and portfolio managers
- Regulation and supervision of investment funds

The Law in the Attachment covers these areas. It provides for the organization, governance, operations, and regulation and supervision of investment funds. It establishes a new legal entity, an "investment fund," as the vehicle for aggregating investments of individual investors for investment in securities.

### **Legal form of investment fund**

With respect to the form of an investment fund, a new legal entity of a fund is recommended as the entity which has the least cost of administration since investors pay for the administration expenses of a fund and such costs reduce the return on their investment. However, Article 33 of the Civil Code provides:

*33.1. Profit-making legal persons shall be established in the form of partnership or company.*

*33.2. Non-profit juristic persons shall be established in the form of association, foundation or cooperative.*

These provisions are at variance with international practice and reflect inappropriate central planning. Reportedly in Mongolian "foundation" and "fund" is the same word although the meaning can be quite different since there are many types of funds but foundations usually have a charitable or public benefit connotation. The basic formalities for the administration of limited partnerships or companies are relatively costly and can be very costly if shareholders or partners challenge the administration of these entities. In addition for companies, certain provisions of the Companies Law are unsuited to investment funds or could considerably complicate the business of an investment fund. These are in Articles 5, 15, 17, 30, 62, 87, and 88. Thus, these forms of business for an investment fund should be avoided.

There are three alternative possibilities to consider to overcome the obstacle of Article 33:

- The law could provide that Article 33 of the Civil Code is not applicable to investment funds for which there reportedly is precedent in exemption from certain articles of the Code in other laws. The Civil Code could also be amended to remove the arbitrary provisions of Article 33.

- A fund could be a contractual relationship between investors and fund sponsors by which the fund sponsor would arrange for the management of common investment portfolios on behalf of investors. Different portfolios would have different investment strategies.
- A fund could be in the form of a trust, a new type of legal entity. This would require the enactment of a trust law but by the time market conditions are conducive for investment funds in Mongolia for investment in Mongolian debt and equity securities, a trust law could be enacted. Trusts are also useful for development of the financial sector in other areas—pension funds, insurance, and securitization of financial assets. Trusts are the form of investment funds in several common law jurisdictions and some civil law jurisdictions have authorized trusts.

A possible fourth form for a fund would be an investment cooperative but this would be well beyond common practice and would not enhance the reputation of the Mongolian financial sector.

### **Available assets for investment**

The key issue for the feasibility of establishment of investment funds in the near term in Mongolia is eligible assets for investment fund investment. The availability of investible assets in the near term is problematic. There are an insufficient number and volume of liquid equity securities listed on the Mongolian Stock Exchange and there is no real market in the few listed corporate bonds. There are government bonds that could be bought by investment funds, but this would have a more limited benefit to the economy than corporate finance.

There are attractive investment opportunities in non-listed companies. However, the interest of such companies in having investments from the new investment funds and the liquidity of such investments are not apparent. Regarding the interest of the companies, investment funds could not bring the indirect business opportunities of many other investors. Regarding liquidity, some unlisted companies by their charter or a shareholders' agreement require that their shares be held for a number of years or that they may be sold in the first instance only to existing shareholders. If the shareholders are not interested in acquiring more shares when they have intimate knowledge of the company, it would be difficult to find other investors to purchase the shares of that company held by an investment fund or at an attractive price. There is also much competition by private equity funds with foreign investors for equity investment in and lending to profitable non-listed companies so the opportunities for investment fund investment in such companies would be limited for this reason as well. Investment funds would be permitted to invest some portion of their assets in equity and fixed income securities listed on major foreign stock exchanges but this would have limited benefit for the Mongolian economy.

### **Regulation and supervision**

The Law provides for investment fund sponsors, which are banks or securities brokers, to organize investment funds. Investment fund investment portfolios would be managed by banks or securities brokers that have an assets management capability and are not affiliated with the fund sponsor. Investors would invest in investment fund "units" which are a type of security and would be sold pursuant to the issuance of a prospectus containing comprehensive information about a fund's administration, governance, risk factors, and how investors may sell their units.

The Law contains general provisions for the regulation and supervision of investment funds. In addition, since investment fund units are securities and at least some funds will have securities

brokers as sponsors or investment fund portfolio managers, the administration and management of investment portfolios of investment funds will be supervised under the securities law by the Financial Regulatory Commission (FRC) since securities brokers are licensed under that law. In addition, the central securities depository and sub-custodians of investment fund assets will also be subject to FRC supervision.

The Law is consistent with the IOSCO Principles for Collective Investment Schemes. The IOSCO Principles have three general objectives: the protection of investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk. The Principles for Collective Investment Schemes, which the Law includes as well as many others, include:

- Segregation of investors' assets
- Disclosure of information to investors
- Suitability for investors of investment fund investments
- Rules for redemption of investment fund investments

## **SECTION I: GENERAL PROVISIONS**

---

### **Article 1. Scope of Application of the Law; Regulation and Supervision**

Article 1 provides for legal personality for an “investment fund” that is the power to enter into contracts, own property, issue obligations, and be a party to legal proceedings. This is instead of an investment fund in the form of a company, given the relatively narrow line of business of an investment fund, to reduce the operational expenses that would be incurred in complying with corporate formalities which would reduce the returns to investors.

An investment fund aggregates the investments of fifty or more natural or legal beneficial owners and invests the proceeds in fixed income or equity securities. To differentiate investment funds from a sovereign wealth fund of the Government or a human development fund, the Law provides that an investment fund sponsor or investor may not be directly or indirectly a government entity or an enterprise the majority of whose equity is owned directly or indirectly by the government. Investment funds shall be regulated and supervised by the Financial Regulatory Commission.

There are several investment vehicles in Mongolia informally known as investment funds that have local and foreign investors that invest in shares and bonds of Mongolian companies that are not listed on the Mongolian Stock Exchange (MSE). A key attribute of investment funds is their investment in liquid securities, those that can be readily sold on a securities exchange so that investors can readily redeem their investments by the fund selling some assets to pay their investors. This is not the case of the private equity funds. To differentiate the investment funds covered by the Law, the Law could be called the Law on Unit Investment Funds since the investments of investment fund investors will be in equity securities known as “investment fund units” to differentiate them from shares in ordinary companies and the type of investment fund covered by the law could be called “unit investment funds.” This has some precedent in some common law countries like the United Kingdom where collective investment schemes are generally called “unit investment trusts.”

### **Article 2. Definition**

Article 2 contains definitions to make the law more precise and concise. For example the law contains a definition of “directly or indirectly” to prevent abusive transactions or exploitation of conflicts of interest in investment fund operations. This term is defined as “an action by a person himself or by acting through one or more intermediaries including one or more affiliates, or related persons to the person, or a group of unrelated persons acting in concert with the person.” To clarify this definition, “related persons” is also defined in Article 2 as are terms used in this definition.



## **SECTION II: INVESTMENT FUND ORGANIZATION, MANAGEMENT AND GOVERNANCE**

---

### **Article 3. Investment Fund Sponsors**

Article 3 provides that investment fund sponsors are to be licensed by the Commission and may be securities brokers licensed by the Commission that have twice the minimum required regulatory capital, or banks licensed by Mongolbank. The capital requirement for brokers is to seek to ensure that the securities broker has adequate financial and managerial resources and information technology systems to perform investment fund sponsorship services. A license to act as an investment fund sponsor shall be issued if in the judgment of the Commission: (i) the applicant has adequate financial and managerial resources for the activities it proposes to undertake; (ii) its business plan for investment fund sponsorship is realistic and demonstrates that it will conduct the activity prudently and competently; and (iii) the applicant's ownership structure does not involve holding companies in foreign jurisdictions or indirect investments that would obscure identification of transactions of related persons to the licensee. A license will require continuing professional education for staff of the licensee involved in investment fund sponsorship.

### **Article 4. Investment Fund Licensing; Involuntary Liquidation**

An investment fund must be licensed by the Commission and an investment fund sponsor will apply for a license for a particular investment fund. It is expected that investment fund sponsors will be sponsors of more than one fund to make its operations efficient and to reduce the costs of administration for each fund since there are economies of scale in funds administration.

A license will be granted by the Commission if, in its opinion, the applicant has qualified prospective trustees and a realistic business plan for the fund. If the aggregate net asset value of outstanding equity units of an investment fund falls below one-half of the minimum required, which would indicate that the fund has incurred significant losses (or loss of faith by investors in the fund which would mean increased costs to remaining investors), the Commission may order that the investment fund be liquidated or that other remedial action be taken in the interest of protection of the investors in the investment fund.

### **Article 5. Investment Fund Organization**

The investment fund sponsor shall manage communications between the fund and its investors, arrange for the transmittal of investors' moneys for investment in the fund and for distributions and assure the preparation and distribution of the required periodic reports and disclosures by the fund to the Commission and to its investors.

An investment fund sponsor shall establish rules for the investment fund setting forth its policies concerning portfolio management arrangements, eligible investments, distributions of income and capital gains, sales of units, redemptions, repurchases and transfers of units, and fees and charges, and such other matters as the Commission may prescribe by regulation.

An investment fund must invest at least 80% of its total assets in transferable securities. Its investment portfolio will be managed by a company which is licensed by the Commission that has an investment advisory business. It will be appointed by the investment fund's board of trustees and must not be affiliated with or a party related to the investment fund's sponsor or its trustees. To seek to prevent misallocation or misappropriation of investment fund assets, an investment fund must maintain its assets that are securities in the central securities depository

or a sub-custodian of the central securities depository and cash assets in the safekeeping of a bank custodian

#### **Article 6. Investment Fund Governance**

Article 6 provides for investment fund governance. A board of trustees, initially appointed by the investment fund sponsor, is responsible for establishing the policies for the operations of the fund, establishing its rules, and overseeing their implementation. The board will appoint the investment fund portfolio management company, any central securities depository sub-custodian, and a bank custodian. The board will meet no less frequently than six times each year. An investment fund must be audited annually by an independent external auditor in accordance with International Auditing Standards for investment funds and the auditor must issue an auditor's opinion and a management letter.

#### **Article 7. Investment Fund Trustees' Qualifications**

Article 7 provides for investment fund trustees' qualifications. Each trustee of an investment fund must have the following minimum qualifications: ten years' experience in the securities brokerage, investment portfolio management, investment analysis, commercial banking, accounting, or auditing business; and a tertiary education degree in economics, finance, accounting, business administration, engineering, or law. With respect to disqualifying factors, no person may serve as an investment fund trustee who has been convicted of a crime or who has been penalized in a civil lawsuit for fraud.

## **SECTION III: INVESTMENT FUND OPERATIONS**

---

### **Article 8. Investment Fund Portfolio Management**

Article 8 provides for investment fund portfolio management. The board will appoint a company to act as the investment fund portfolio manager which must be a licensed securities broker, or a licensed bank that has demonstrated to the satisfaction of the board its portfolio management capability. In turn, to ensure accountability for the portfolio management, the investment fund portfolio management company must appoint one or more persons to manage the investment portfolio of the investment fund. The terms and conditions for engagement by an investment fund of an investment portfolio management company for such matters as compensation and expense reimbursement shall be comparable to those for similar engagements in the securities industry. Also to seek to ensure accountability, an investment portfolio management company may be dismissed by the board with or without cause.

### **Article 9. Investment Fund Unit Initial Distribution and Subsequent Sales**

Article 9 provides for investment fund unit initial distribution and subsequent sales. The Commission must approve a prospectus for the issuance of fund units by the fund. After the initial sales, a copy of the prospectus and copies of the latest annual report and all subsequent interim reports of the fund must be provided to a purchaser of investment fund units not later than the second business day after the date of purchase or the purchaser may rescind the purchase. An investor could be required to certify that he or she has read the prospectus before submitting a purchase request which probably would not be observed. However, if the prospectus is received within two days of purchase, if based upon it the purchaser decides to sell, the value of the units purchased probably would not have changed significantly in such short timeframe.

### **Article 10. Offering Material Misstatements and Omissions**

Article 10 provides requirements for materials used to sell fund units on the important matter of the truth of information provided. If any part of the prospectus for an investment fund or an advertisement contains a material misstatement or omits to state a material fact, the investment fund or its underwriter must file with the Commission and publish an amendment that remedies such material misstatement or omission. The Commission may issue a temporary order prohibiting further use of a prospectus or advertisement containing false or insufficient information, either absolutely or unless amended as specified by the Commission.

### **Article 11. Duties of an Investment Fund Sponsor**

Article 11 contains detailed duties of an investment fund sponsor. These include calculating the net asset value of fund units; maintaining the accounting records; ensuring the segregation of investment fund assets; and preparing the financial statements of the investment fund. The investment fund sponsor will file annual reports and interim reports with respect to the investment fund in accordance with requirements for disclosure of information concerning securities as required by the law on securities. These would be available to fund investors and to the public generally so that securities analysts and asset managers can assess the performance of the fund.

There are also requirements for sales and redemption of investment fund units. Investment fund units will be of two types, either listed on the MSE and sales will be at the price offered on the exchange, or the sponsor will redeem units at their net asset value.

### **Article 12. Custody of Investment Fund Assets; Account Statements**

Article 12 provides for custody of investment fund assets and for statements of their accounts to be sent to fund investors by both the custodian and an investment fund sponsor. An investment fund must arrange for the central securities depository or an intermediary depository to transmit to investment fund investors statements of each investor's investment held by the securities depository or an intermediary depository in each month in which securities trades are made by the investment fund that reflect any change in investor's account in that month. An investment fund must send to its investors quarterly statements of their investment in the fund and confirmations of trades in fund units requested by the investor within one business day of the trade date. Based on these requirements, an investor may determine whether there is any discrepancy between statements of their accounts by the investment fund sponsor and those of the depository to seek to protect against fraud by an investment fund sponsor.

An investment fund must provide for its investors reports, no less frequently than quarterly, on the activity of the investment fund. These reports must include: the value of the investment fund at the beginning and at the end of the reporting period; the percentage change in value of the fund; the ten largest holding of the fund and the percentage of fund assets that such holdings represent, and the performance of a benchmark investment portfolio for that period. By requiring disclosure of a fund's performance against a benchmark of comparable investments or the MSE as a whole, an investor can decide whether he wishes to retain the investment or seek alternative investments.

### **Article 13. Duties of an Investment Fund Custodian**

Article 13 contains duties of an investment fund custodian. The arrangements for registration and custody of securities are changing in Mongolia and it is likely that the central securities depository will register securities owned by an investment fund in the name of the fund and a sub-custodian, a bank, will register the owners of the units of an investment fund.

Thus, a custodian of an investment fund must be a bank meeting eligibility criteria and operational capacity prescribed by the Commission to act as a securities custodian; not be an affiliate of the investment fund sponsor or investment fund underwriter; segregate from its own assets, and separately identify, the assets of the investment fund entrusted to it for safekeeping and take such other steps as may be required under applicable law to prevent the assets of the investment fund from being subject to claims of creditors of the custodian; and be subject to audits or inspections prescribed by the Commission to verify the assets of the investment fund. A custodian of an investment fund has a duty to act in the best interests of the investment fund investors.

### **Article 14. Conduct of Business Rules for Investment Funds**

Article 14 contains conduct of business rules for investment funds. An investment fund sponsor and investment fund portfolio management company must act honestly, fairly and professionally and comply with the regulations of the Commission in this regard. An investment fund sponsor and investment fund portfolio management company must not engage in fraud or deceit and must place their investors' interests before their employees', affiliates', or other related parties' interests.

All information, including marketing communications, addressed by an investment fund to investors or potential investors shall be fair, clear and not misleading. Information must be provided in a comprehensible form to investors or potential investors about: the investment fund's organization and operations, its key administrative and managerial personnel, and its services; financial instruments to be invested in by the fund and proposed investment

strategies, including guidance on and warnings of the risks associated with those investments; and fees and expenses of the investment fund for the account of investors in the fund.

When offering directly or indirectly their units for sale, the investment fund or its agent must obtain information regarding the investor's or potential investor's knowledge and experience in the investment field relevant to investment funds, his financial situation, and his investment objectives. An investment fund may sell to a potential investor only the investment funds that are suitable for him. An investment fund's relationship with investors must be set out in a comprehensive investment agreement.

Investment fund trustees, sponsors and investment advisors to investment funds must introduce suitable arrangements and procedures so that they and their administrators and employees are not placed in a situation where their duty to one customer conflicts with their duty to the investment fund, or where their own interest conflicts with their duty to the investment fund.

### **Article 15. Prohibited Transactions with respect to an Investment Fund**

Article 15 contains rules to ensure diversification of assets of an investment fund. An investment fund may not: invest more than ten percent of its total assets in securities of a single issuer other than debt securities issued or fully guaranteed by the State or the central bank; acquire more than twenty percent of the outstanding voting securities of an issuer; invest more than thirty percent of its total assets in securities traded on a foreign securities exchange; or engage in short sales. By permitting up to thirty percent of investment fund assets to be invested on foreign securities exchanges, the Law permits access to securities that may have more liquidity than many traded on the MSE and diversification into other industry sectors and economies. Since Mongolian investors have flexibility as to currencies in which to invest, exposure to foreign exchange risk for investment funds should be manageable. Instead of having specific percentage limitations specified in the Law, the Law could provide that such percentages will be determined by regulation of the Commission but potential sponsors may wish to have certainty as to the parameters of the asset composition of a fund.

There is also a general rule that no investment fund sponsor, investment portfolio management company, or custodian of an investment fund shall engage in any transaction with respect to an investment fund or its assets involving self-dealing or transactions with an affiliate or related persons to the detriment of the investment fund or its investors.



## **SECTION IV: PROHIBITIONS ON PRACTICES WITH RESPECT TO INVESTMENT FUNDS**

---

### **Article 16. Misuse of Information, Fraud; Insider Trading; Material Misstatements**

Article 16 prohibits objectionable practices of misuse of Information, fraud, insider trading, and material misstatements with respect to investment funds. No person connected as an administrator, employee, or agent with an investment fund sponsor or investment portfolio management company or securities broker for an investment fund, may use for personal benefit or the benefit of others information obtained related to the investment fund, its investments, its investors, or its investment strategy, proposed transactions or transactions by the fund which is not public information.

This article also prohibits fraudulent or deceitful conduct or making an untrue statement of a material fact or omitting to state a material fact necessary to make the statements made not misleading in connection with the purchase or sale of any investment fund unit, the making of a required disclosure by the investment fund in a filing with the Commission or any solicitation of investment fund investors.

### **Article 17. Manipulation; Churning; Touting; Front Running**

Article 17 prohibits specific unfair trading practices with respect to an investment fund—manipulation, churning, and front running. Manipulation is the creation of a false or misleading appearance of active trading in any investment fund units, the creation of a false or misleading appearance with respect to the market for any investment fund units, or the manipulation of the market price of investment fund units.

Churning is making recommendations to trade or effecting trading on a discretionary basis for an investment fund to increase brokerage commissions or advisory fees for transactions that are excessive in volume or frequency in relation to the size and character of the fund or the needs and objectives of the fund. Front running is purchasing or selling securities by securities market intermediaries like investment portfolio managers or securities brokers based on advance knowledge of securities analysts' reports before such analysis is disseminated to customers or trading before execution of customers' trades based on knowledge of customers' imminent trades. Front running would enable such intermediaries to purchase securities at prices lower than those that would be available to their customers or sell securities at prices higher than those of their customers.

### **Article 18. Falsification of Accounting, Financial Records, Filings**

Article 18 prohibits falsification of accounts, financial records, or regulatory filings of an investment fund by an investment fund sponsor, investment fund portfolio management company, or securities broker.



## **SECTION V: ENFORCEMENT REGARDING VIOLATIONS OF LAW**

---

### **Article 19. Investigations**

Article 19 contains provisions on powers of the Commission to undertake investigations if it suspects that there has been a violation of the Law or related regulations. The articles in Section V as well as those in Section VI on Miscellaneous Provisions relate to matters that are relevant for any securities law and may serve as model articles for the new securities law. They are included in this Law on investment Funds since this Law is a separate law and investment fund units are securities.

The Commission may investigate the activities and financial statements of an investment fund sponsor, trustee, investment fund portfolio management company, securities broker, officers or employees of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker, or their affiliates. The Commission may order witnesses to appear, take evidence, and require the production of books, accounts and other documents and records, including records in electronic form.

### **Article 20. Remedial Measures and Penalties for Civil Infractions**

Article 20 contains remedial measures and penalties for civil infractions. It provides criteria for the imposition of a range of discretionary enforcement measures which include: a written agreement with a company's trustees or board of directors to provide for a program of

remedial action; an order to cease and desist from certain infractions and to undertake remedial actions; an order that a transaction in the purchase or sale of securities be rescinded; a consent decree; the disgorgement of profits made or payment of the amount of losses avoided by a violation; and suspension or dismissal of any administrator of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker from their positions.

This article includes the concept that a violator who voluntarily reports a violation on a timely basis will receive less severe penalties than others whose violation is discovered by the FRC or some other person. Violators have the best information and it is important to encourage early reporting of violations that otherwise could go undetected. An important complementary provision would be whistleblower protection in the Company Law.

Article 20 also introduces the consent decree by which an alleged violator, without admitting or denying the alleged violation, agrees to undertake remedial action that may include restitution of damages incurred by investors from the alleged violation and payment by an alleged violator of the Commission's investigative costs and related expenses. This is usually the best way to resolve a violation of securities law because it greatly reduces the time and expense of resolving an infraction compared to contested proceedings like ordinary litigation whose outcome may also be uncertain if judges are not knowledgeable about the intricacies of financial accounting and securities law.

### **Article 21. Criminal Offenses**

Article 21 lists criminal offenses as distinguished from civil infractions. These are violations that are punishable by a fine or imprisonment for any investment fund sponsor, trustee, investment fund portfolio manager, investment fund securities broker, or any officer or employee of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker or any administrator relating to the falsification of books of

account or records of such legal persons or of a customer of such entity. Suspected criminal offenses will be referred by the Commission to the Public Prosecutor's Office.

## **SECTION VI: MISCELLANEOUS PROVISIONS**

---

### **Article 22. Segregation of investment Fund's and Investment Fund's Investors' Assets**

Article 22 contains a general requirement for an investment fund sponsor, investment fund portfolio management company, an investment fund securities broker, and an investment fund custodian to segregate the investment fund's and investment fund investors' moneys and securities from their own moneys and securities, so they are not subject to attachment by creditors of those entities in the event of their insolvency or unfavorable judgment in a lawsuit. Investment fund assets and investment fund investors' assets are not assets of these securities market intermediaries and must not be used to satisfy liabilities to creditors of such securities market intermediaries.

### **Article 23. Regulatory Determinations**

This article provides a procedure for regulatory determinations to clarify areas of the Law that particular investment fund sponsors, investment fund portfolio management companies or investors want clarified in connection with a proposed course of action. If such person believes that the application of the Law to a situation or transaction affecting them requires a regulatory determination, they may submit a letter to the Commission setting forth the facts of their case and their belief as to the application of the law or any regulation to their case. The Commission within thirty days of the submission of an inquiry must issue its opinion to the applicant stating whether the Commission would take enforcement action with respect to the circumstances indicated.

To build a body of guidance regarding the Law, letters of request and responses of the Commission will be indexed under the applicable section of the Law or regulations and will be made available to the public on the Commission's website. The name of the applicant as well as any other information that may identify the applicant or disclose confidential business information shall be redacted from the public file.

### **Article 24. Private Right of Action**

Article 24 provides that a person who in good faith believes that another person has violated one or more provisions of this Law to their detriment may sue in a court of law for redress. The remedies are indicated. The court may issue an injunction compelling a person to comply with the Law, order rescission of a transaction, order disgorgement of profits made or the amount of losses avoided by a violation, or order a violator to pay damages to compensate the aggrieved party.

### **Article 25. Imputed Liability**

Article 25 provides for imputed liability to make persons aware that they cannot escape liability by encouraging others to violate the Law. Thus, any person who assists another person in the violation of: (i) a provision of the Law; (ii) any regulation or order of the Commission issued pursuant to the Law; or (iii) any rule of the central securities depository issued pursuant to the Law with knowledge of the violation, shall be liable to the same extent as the other person for the violation. Administrators of a legal person are liable for the acts of such legal person, unless they demonstrate that they have not been and could not have been aware of the violation.

### **Article 26. Resolution of an Investment**

Article 26 provides for resolution of an investment fund insolvency in an expeditious and efficient manner so that investors' savings are not frozen pending resolution of a bankruptcy proceeding. Expeditious and fair resolution of insolvency of an investment fund is vital to contain damage to the reputation of the securities market. Insolvency resolution significantly affects the rights of stakeholders. In the absence of a modern bankruptcy law, this article employs progressive provisions for the efficient resolution of insolvency of an investment fund.

Thus, if the Commission determines that an investment fund is not paying its liabilities as they fall due, the Commission will appoint a receiver to take control of the investment fund and its assets, liquidate the assets and return the net proceeds to investors. Unlike an industrial or commercial company which when insolvent may be worth rehabilitating to save employment and continue the supply of goods or services, there is nothing unique about investment fund services and investors of an insolvent fund would be advised to move their investments to a well-managed fund.

#### **Article 27. Evidence**

Article 27 provides that electronic data or records of an investment fund sponsor, an investment fund, an investment fund portfolio management company, an investment fund securities broker, a stock exchange, the central securities depository, or a sub-custodian of the central securities depository may be admitted in evidence. Some rules of civil procedure exclude such evidence and investment fund activity is documented largely by computer records.

#### **Article 28. Interpretation Fund Insolvency**

Article 28 provides rules of interpretation of the Law. For example, terms used in the conjunctive or disjunctive in the Law may be read vice versa whenever the change is necessary to effectuate the obvious intention of the provision in question and a masculine pronoun includes the feminine and neuter pronoun.





## **ANNEX A: LAWS ON INVESTMENT FUNDS**

---

### **Section I. General Provisions**

#### **Article 1. Scope of Application of the Law; Regulation and Supervision**

1. This law applies to the organization, governance, operations, and regulation and supervision of investment funds.
2. An investment fund is a legal entity with the power to enter into contracts, own property, issue obligations, and be a party to legal proceedings.
3. An investment fund shall aggregate the investments of fifty or more natural or legal beneficial owners and invest the proceeds in fixed income or equity securities. A corporation, partnership or other legal entity shall be counted as one person.
4. The liability of an investor in an investment fund to an investment fund in his capacity as an investor is limited to the amount of the investor's investment in the fund.
5. An investment fund sponsor or investor may not be directly or indirectly a government entity or an enterprise the majority of whose equity is owned directly or indirectly by the government.
6. Investment funds shall be regulated and supervised by the Financial Regulatory Commission (hereinafter known as the "Commission").

#### **Article 2. Definitions**

The following definitions apply to this Law:

1. Administrators: natural persons, by whatever title held, who act as the chief executive officer, chief financial officer, chief operating officer, members of the governing body, or as heads of departments or other administrative units of a legal person.
2. Affiliate of a specified person, or person affiliated with a specified person: a person that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the specified person.
3. Beneficial ownership: a person is a beneficial owner of securities when the person has the right to them, whether or not they are registered in his name.
4. Bond: a written evidence of debt issued by a company that specifies the terms of borrowing and repayment.
5. Central securities depository: An entity that: maintains records of ownership of securities listed on one or more securities exchanges; arranges for the clearing and settlement of trades in such securities; and records transfers of ownership reflecting trades in such securities.
6. Control: means the power, directly or indirectly, to exercise a determinative influence over the management or policies of a company either alone or pursuant to an arrangement or understanding with one or more other persons, whether through the ownership of voting securities, by agreement, or otherwise. A person who (either alone or pursuant to an understanding with one or more persons) owns or has the power to vote more than 25% of the outstanding voting securities of a company is presumed to control. Any other person is presumed not to control by virtue solely of his ownership or power to vote. Any such presumption may be rebutted by evidence.
7. Custodian: any person that holds securities or cash for the account of others.

8. Directly or indirectly: an action by a person himself or by acting through one or more intermediaries including one or more affiliates, or related persons to the person, or a group of unrelated persons acting in concert with the person.
9. Investment fund: A legal entity that: (i) aggregates funds of fifty or more beneficial owners; (ii) has only one class of equity unit, with each equity unit representing an undivided interest in the net assets and net income of the investment fund and with the liability of the holder of an equity unit limited to his interest in the net asset value thereof; and (iii) invests at least 80% of its total assets in transferable securities.
10. Investment fund sponsor: A securities broker that has twice the minimum required regulatory capital, or a bank, that performs administrative activities for the organization and operation of an investment fund.
11. Investment services provider: a securities broker, an underwriter, or an investment fund.
12. Listing: the admission to trading on a regulated securities exchange of the securities of an issuer.
13. Material Information: information on matters as to which there is a substantial likelihood that a reasonable security holder, potential buyer, or seller of securities would attach importance in determining its price and whether to hold, buy, or sell a security.
14. Misleading information: a written or oral communication (including, but not limited to, a prospectus, advertisement, or a solicitation to purchase or sell a security) that includes an untrue statement of material fact or omits to state a material fact required to be included or necessary to make the statements made therein not misleading, where the prospective purchaser or seller does not know of such misstatement or omission.
15. Option: any contract or arrangement pursuant to which the holder or grantee thereof has the right, but not the obligation, to purchase or sell, or to deliver or receive, from or to the issuer or grantor thereof, the subject of such contract or arrangement or a cash amount.
16. Related persons to a securities broker or underwriter: (i) any administrator of the securities broker or underwriter; (ii) any principal shareholder of the securities broker or underwriter; (iii) any natural person who is related to such administrator or principal shareholder by marriage, consanguinity to the second degree, or business interest; (iv) any partnership or company in which any administrator or principal shareholder has a significant interest; and (v) any person that has a significant interest in a legal person in which the securities broker or underwriter has a significant interest.
17. Security: any evidence of indebtedness; equity interest, share, investment fund unit, investment contract; certificate of interest or participation in a profit-sharing agreement; limited partnership interest; pre-organization subscription; any option on a security, or group or index of securities, including an interest in or based on the value of any of the foregoing; or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, or warrant or right to subscribe to or purchase, any of the foregoing. The term does not include: (i) obligations of a bank regulated under the laws of Mongolia that (a) are entered into by the bank in the ordinary course of its banking business directly with its customers and not through intermediaries and (b) are not transferable; (ii) debt obligations that mature within, and may not be renewed or extended to or beyond, one year from the date of their original issuance; (iii) insurance policies or annuity contracts under which an insurance company regulated under the laws of Mongolia promises to pay a fixed sum of money, either in a lump sum or periodically for life or some

- other specified period; or (iv) an interest in a contributory or noncontributory pension plan subject to regulation under the laws of Mongolia.
18. Securities broker: a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account, except that the term does not include: (i) the State; (ii) the Bank of Mongolia; or (iii) a person that buys and sells securities for his own account, either individually or in some fiduciary capacity, and not as part of a regular business.
  19. Securities distribution: the sale or disposition of an issue of securities or an interest in securities so issued for value to a number of persons.
  20. Securities exchange: an organized market for the purchase and sale of securities that are listed on the exchange.
  21. Significant interest: a direct or indirect ownership of an interest in a legal person or undertaking that represents the equivalent of twenty percent or more of the equity or of any class of shares with voting rights, or that makes it possible to exercise a significant influence over the management or policies of that legal person or undertaking.
  22. Underwriter: any person who: (i) offers or sells securities of an issuer for the issuer; or (ii) purchases securities of an issuer from the issuer with a view to an offering and sale within one year.

## **Section II. Investment Fund Organization, Management and Governance**

### **Article 3. Investment Fund Sponsors**

1. An investment fund sponsor must be licensed by the Commission.
2. An investment fund sponsor may be a securities broker licensed by the Commission that has twice the minimum required regulatory capital, or a bank licensed by Mongolbank.
3. The Commission by regulation shall issue the form of application for sponsor applicants to submit information concerning their business history, financial responsibility, and operational capacity.
4. A license to act as an investment fund sponsor shall be issued if in the judgment of the Commission: (i) the applicant has adequate financial and managerial resources for the activities it proposes to undertake; (ii) its business plan for investment fund sponsorship is realistic and demonstrates that it will conduct the activity prudently and competently; and (iii) the applicant's ownership structure does not involve holding companies in foreign jurisdictions or indirect investments that would obscure identification of transactions of related persons to the licensee.
5. A license will require continuing professional education for staff of the licensee involved in investment fund sponsorship for the maintenance of the license.
6. If the Commission denies a license application, it shall provide the reasons therefore.

### **Article 4. Investment Fund Licensing; Involuntary Liquidation**

1. An investment fund must be licensed by the Commission.
2. An investment fund sponsor shall apply for a license on behalf of an investment fund.
3. A license will be granted by the Commission if, in its opinion, the applicant has qualified prospective trustees and a realistic business plan for the fund.
4. If the Commission denies a license application, it shall provide the reasons therefore.



### **Article 6. Investment Fund Governance**

1. Within fifteen days of the licensing of an investment fund, the investment fund sponsor shall appoint a board composed of the three trustees who were proposed in its license application.
2. The board of trustees shall be responsible for establishing the policies for the operations of the fund, establishing its rules, and overseeing their implementation.
3. The board of trustees shall appoint the investment fund portfolio management company, any central securities depository sub-custodian, and a bank custodian.
4. The board shall meet no less frequently than six times each year, at least once in each calendar quarter.
5. The trustees shall fix their compensation which may not exceed the amount set by regulation of the Commission for each meeting attended.
6. At the end of its first year in office, the board shall appoint three new trustees that meet the requirements for investment fund trustees. The new trustees may be reappointed for up to five successive one-year terms of office.
7. An investment fund shall be audited annually by an independent external auditor in accordance with International Auditing Standards for investment funds and the auditor shall issue an auditor's opinion and a management letter.

### **Article 7. Investment Fund Trustees' Qualifications**

1. Each trustee of an investment fund must have the following minimum qualifications:
  - a. Ten years' experience in the securities brokerage, investment portfolio management, investment analysis, commercial banking, accounting, or auditing business; and
  - b. A tertiary education degree in economics, finance, accounting, business administration, engineering, or law.
2. No person may serve as an investment fund trustee who has been convicted of a crime or who has been penalized in a civil lawsuit for fraud.

## **Section III. Investment Fund Operations**

### **Article 8. Investment Fund Portfolio Management**

1. The board shall appoint a company to act as the investment fund portfolio manager.
2. An investment fund portfolio management company shall be a licensed securities broker, or a licensed bank that has demonstrated to the satisfaction of the board its portfolio management capability.
3. The investment fund portfolio management company shall appoint one or more persons to manage the investment portfolio of the investment fund.
4. The individuals who act as managers of an investment fund portfolio may have duties other than as portfolio manager of the fund for which they are appointed, including those as investment portfolio managers of other investment funds.
5. The terms and conditions for engagement by an investment fund of an investment portfolio management company for such matters as compensation and expense reimbursement shall be comparable to those for similar engagements in the securities industry.

6. The investment portfolio management company may be dismissed by the board with or without cause.

#### **Article 9. Investment Fund Unit Initial Distribution and Subsequent Sales**

1. No person may cause an investment fund to engage in any business, and no person may sell units of an investment fund as a result of which it will have fifty or more beneficial owners, unless the Commission has approved a prospectus for the issuance of fund units by the fund.
2. The investment fund sponsor or the investment fund underwriter must deliver to the purchaser of investment fund units, (i) for the initial offering of units not later than the second business day prior to the date of purchase, and (ii) for subsequent purchases, not later than the second business day after the date of purchase, a copy of the prospectus relating to the securities filed with the Commission and copies of the latest annual report and all subsequent interim reports required to be filed with the Commission pursuant to the law on securities.
3. If a purchaser has not received the required documents within the required timeframe, the purchaser may unilaterally rescind the purchase of investment fund units by transmitting a notice of rescission to the investment fund sponsor, underwriter, or seller, as the case may be, within two business days after the receipt of such documents. Such rescission shall be effective by operation of law from the receipt of the notice.

#### **Article 10. Offering Material Misstatements and Omissions**

1. In the event that, prior to the completion of sales of investment fund units by the investment fund or its underwriter, any part of the prospectus or advertisement in lieu of prospectus contains a material misstatement or omits to state a material fact necessary to make the statements made therein, in the light of circumstances at the time of sales of the units by the investment fund or its underwriter, not misleading, the person that prepared and filed such part or published such advertisement shall file with the Commission, and, if required by the Commission, publish an amendment or supplement thereto that remedies such material misstatement or omission.
2. For the purpose of enabling the issuer or such other person to fulfill its duties under paragraph 1, the person or persons selling the investment fund units shall advise the investment fund and such other person as to when sales are to begin and when sales have terminated.
3. If at any time it appears to the Commission that a prospectus, or any part thereof, or advertisement in lieu of prospectus is on its face inaccurate or incomplete in any material respect, the Commission may issue a temporary order prohibiting further use of such prospectus or advertisement, either absolutely or unless amended as specified by the Commission. The Commission shall provide an opportunity for a hearing for the affected person within five days of the issuance of the order, and the order shall remain in effect until the hearing is completed.

#### **Article 11. Duties of an Investment Fund Sponsor**

1. The investment fund sponsor has a duty to act in accordance with applicable law and the fund rules and in the best interest of the fund investors.
2. The investment fund sponsor shall be responsible for:
  - a. calculating the net asset value of fund units;

- b. acting as agent for the receipt and disbursement of moneys from and to fund investors;
  - c. maintaining the accounting records;
  - d. ensuring the segregation of investment fund assets;
  - e. preparing the financial statements of the investment fund; and
  - f. submitting account statements and reports concerning the fund to fund investors.
3. Sales and redemption of investment fund units shall observe the following requirements:
- a. The investment fund sponsor may not issue units, or resell units purchased using funds of the investment fund, for less than the approximate net asset value thereof, excluding sales commissions.
  - b. The investment fund sponsor must make arrangements, which shall be described in the rules of the investment fund, for fund investors to be able to dispose of their units within a reasonable period (which shall be not more than three months) in exchange for the approximate net asset value thereof; provided, however, that no such arrangements need be made in the case of units if, in the case of a closed end or exchange traded funds: (i) the fund rules prohibit the repurchase or redemption of equity units using funds of the investment fund; (ii) the fund rules provide that the fund units are transferable, and (iii) the fund units are traded on a securities exchange.
  - c. Such arrangements may include redemption of units by the investment fund sponsor on behalf of the investment fund using funds of the investment fund, repurchases of units by the investment fund sponsor or another person on its own behalf using its own funds, or any combination of the foregoing.
  - d. The fund rules may provide that units of an investment fund are transferable, and the investment fund sponsor may arrange for their trading on a securities exchange.
4. The investment fund sponsor shall calculate the net asset value of the units of such investment fund in such manner and with such frequency as the Commission may prescribe by regulation, which shall not be less frequently than monthly, and shall cause such net asset value and the date of its calculation to be published promptly thereafter.
5. An investment fund sponsor shall ensure that an investment fund portfolio management company, an investment fund securities broker, and an investment fund custodian shall segregate the investment funds' moneys and securities from their own moneys and securities, in accordance with procedures specified by regulation by the Commission.
6. The investment fund sponsor, investment fund portfolio management companies, and custodians of an investment fund shall maintain such accounting, transaction and other records relating to the offering and sale of units of the investment fund and the operation of the investment fund as the Commission may prescribe by regulation, and shall make such records available for inspection by the Commission.
7. The investment fund sponsor shall file annual reports and interim reports with respect to the investment fund in accordance with requirements for disclosure of information concerning securities as required by the law on securities.

#### **Article 12. Custody of Investment Fund Assets; Account Statements**

1. Where an investment fund or investment fund underwriter receives moneys on behalf of an investment fund investor, the investor's assets in the form of cash must be kept in an

account of that investor in a bank pending instructions from the investor to the bank as to the disposition of those assets. Instructions may be provided in a standardized format.

2. An investment fund sponsor must arrange for the central securities depository or an intermediary depository to transmit to investment fund investors statements of each investor's investment held by the securities depository or an intermediary depository in each month in which securities trades are made by the investment fund that reflect any change in investor's account in that month.
3. An investment fund must send to its investors quarterly statements of their investment in the fund and confirmations of trades requested by an investor within one business day of the trade date.
4. An investment fund must make available for its investors reports, no less frequently than quarterly, on the activity of the investment fund. These reports shall include: the value of the investment fund at the beginning and at the end of the reporting period; the percentage change in value of the fund; the ten largest holding of the fund and the percentage of fund assets that such holdings represent and the performance of a benchmark investment portfolio for that period.

### **Article 13. Duties of an Investment Fund Custodian**

1. A custodian of an investment fund must:
  - a. be a bank meeting eligibility criteria and operational capacity prescribed by regulation of the Commission to act as a securities custodian;
  - b. not be an affiliate of the investment fund sponsor, portfolio management company, or investment fund underwriter;
  - c. segregate from its own assets, and separately identify, the assets of the investment fund entrusted to it for safekeeping and take such other steps as may be required under applicable law to prevent the assets of the investment fund from being subject to claims of creditors of the custodian;
  - d. be subject to such annual or other audits or inspections as may be prescribed by the Commission by regulation to verify the assets of the investment fund maintained by it; and
  - e. provide statements of account to fund investors in any month in which there is a transaction with respect to the purchase, sale or distributions to fund units.
2. A custodian of an investment fund has a duty to act in accordance with applicable law and regulations and the fund rules and in the best interests of the investment fund investors.

### **Article 14. Conduct of Business Rules for Investment Funds**

1. An investment fund sponsor and portfolio management company shall act honestly, fairly and professionally and comply with the regulations of the Commission in this regard. An investment fund sponsor and portfolio management company must not engage in fraud or deceit and must place their investor's interests before their employee's, affiliates, or related parties' interests.
2. All information, including marketing communications, addressed by an investment fund sponsor or underwriter to investors or potential investors shall be fair, clear and not misleading.

3. Information shall be provided in a comprehensible form to investors or potential investors about:
  - a. the investment fund's organization and operations, its key administrative and managerial personnel, and its services;
  - b. financial instruments to be invested in by the fund and proposed investment strategies, including guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies;
  - c. execution of securities trades venues; and
  - d. fees and expenses of the investment fund for the account of investors in the fund.

This information may be provided in a standardized format.

4. When offering directly or indirectly their units for sale, the investment fund or its agent shall obtain information regarding the investor's or potential investor's knowledge and experience in the investment field relevant to investment funds, his financial situation, and his investment objectives. This information may be collected in a standardized format.
5. An investment fund shall sell to a potential investor only the investment funds that are suitable for him. In case the investment fund considers that a fund is not appropriate for the potential investor, the investment fund shall warn the potential investor. This warning may be provided in a standardized format.
6. In cases where the investor or potential investor elects not to provide the information requested, or where he provides insufficient information, the investment fund shall warn the potential investor that such a decision will not allow the investment fund to determine whether the investment fund envisaged is appropriate for him. This warning may be provided in a standardized format.
7. An investment fund shall establish a record that includes the document or documents agreed between it and the investor that set out the rights and obligations of the parties, and the other terms on which the investment fund will be managed. The rights and duties of the parties may be incorporated by reference to other documents or legal texts.
8. Investment fund trustees, sponsors and investment advisors to investment funds shall introduce suitable arrangements and procedures so that they and their administrators and employees are not placed in a situation where their duty to one customer conflicts with their duty to the investment fund, or where their own interest conflicts with their duty to the investment fund.

#### **Article 15. Prohibited Transactions with respect to an Investment Fund**

1. An investment fund may not:
  - a. incur liabilities in excess of ten percent of its total assets including the incurrance of obligations relating to the expenses of its organization and operation, or engage in any investment practices for purposes of leveraging the assets of such investment fund;
  - b. invest in personal property or any other assets except cash, securities and receivables arising from the sale thereof in accordance with normal settlement;
  - c. invest more than ten percent of its total assets in securities of a single issuer other than debt securities issued or fully guaranteed by the State or the central bank.
  - d. acquire more than twenty percent of the outstanding voting securities of an issuer;

- e. acquire more than ten percent of the outstanding equity units of any other investment fund;
  - f. invest more than ten percent of its total assets in units of one or more other investment funds;
  - g. invest more than thirty percent of its total assets in securities traded on a foreign securities exchange; or
  - h. engage in short sales.
2. No investment fund sponsor, investment portfolio management company, or custodian of an investment fund, affiliate of such investment fund sponsor, investment portfolio management company or custodian, or underwriter(s) for such investment fund or affiliate, shall engage in any transaction with respect to such investment fund or its assets involving self-dealing or transactions with affiliates or related persons to the detriment of the investment fund or its investors. The Commission may adopt regulations that (i) establish classes of transactions deemed not to have such effect and (ii) require justification for or prohibit other transactions that may have the foregoing effect.

#### **Section IV. Prohibitions on Practices with respect to Investment Funds**

##### **Article 16. Misuse of Information, Fraud; Insider Trading; Material Misstatements**

1. No person currently or formerly connected as an administrator, employee, or agent with an investment fund sponsor or investment portfolio management company or securities broker for an investment fund, may use for personal benefit or the benefit of others or engage in securities transactions based upon information obtained related to the investment fund, its investments, its investors, or its investment strategy, proposed transactions or transactions by the fund which is not public information.
2. No person shall directly or indirectly engage in fraudulent or deceitful conduct; or knowingly or recklessly make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; in connection with the purchase or sale of any investment fund unit, the making of a required disclosure by the investment fund in a filing with the Commission or any solicitation of investment fund investors.
3. No investment fund sponsor or affiliate of a sponsor may sell or purchase, or offer to sell or purchase, the sponsor's investment fund's units by means of a written or oral communication, including, but not limited to, a prospectus, advertisement, or a solicitation, that includes an untrue statement of material fact or omits to state a material fact required to be included therein or necessary to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

##### **Article 17. Manipulation; Churning; Touting; Frontrunning**

1. No person may purchase, sell, or offer to purchase or sell, investment fund units by: (i) the creation of a false or misleading appearance of active trading in any investment fund units; (ii) the creation of a false or misleading appearance with respect to the market for any investment fund units; or (iii) the manipulation of the market price of investment fund units to facilitate the distribution or purchase of investment fund units.
2. No investment fund sponsor, investment fund portfolio manager, or securities broker shall effect with or for an investment fund with respect to which the investment fund sponsor, investment fund portfolio management company, or securities broker exercises investment

discretion, or is in a position to determine the volume and frequency of transactions by reason of the investment fund's willingness to follow the investment fund portfolio management company's, or securities broker's recommendations, transactions that are excessive in volume or frequency in light of the amount of the investment fund portfolio management company's or securities broker's commissions or fees in relation to the size and character of the investment fund and the needs and objectives of the investment fund.

3. No investment fund sponsor or trustee, investment fund portfolio manager, or securities broker or officer or employee of an investment fund sponsor, or investment fund portfolio management company may trade securities for their own account based on knowledge of prospective trades by an investment fund before the execution of trades for the investment fund.

#### **Article 18. Falsification of Accounting, Financial Records, Filings**

1. No person shall knowingly or recklessly falsify any accounting or financial books or records of any investment fund sponsor, investment fund portfolio management company, or securities broker of an investment fund in a manner that would make them materially misleading.
2. No person shall make, or cause to be made, in a document filed with the Commission or in a proceeding under this Law with respect to an investment fund, a statement that the person knows is, at the time and in the light of the circumstances under which it is made, false or misleading in a material respect.

### **Section V. Enforcement regarding Violations of Law**

#### **Article 19. Investigations**

1. The Commission may conduct such investigations as it deems necessary or appropriate to determine whether a person has violated or is about to violate this Law, a regulation in implementation of this Law, or an order of the Commission hereunder or to aid in enforcement of this Law.
2. The Commission may investigate the activities and financial statements of an investment fund sponsor, trustee, investment fund portfolio management company, securities broker, officers or employees of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker, or their affiliates.
3. The Commission may by regulation or order authorize persons to administer oaths and affirmations, order witnesses to appear, compel their attendance, take evidence, and require the production of books, papers, accounts, correspondence, memoranda, agreements and other documents and records (including records in electronic form in e-mails, SMS messages, databases, computer hard drives, and servers) the Commission considers to be relevant and material to an investigation or proceeding.
4. Any person may file a statement as to the facts and circumstances concerning the matter to be investigated.
5. If a person does not testify or produce the documents required by the Commission or a designated person, the Commission or designated person may apply to a court of competent jurisdiction for an order compelling compliance. Such court may issue an order requiring such person to appear before the Commission or designated person to give testimony or produce documents relating to the matter under investigation. Any failure to obey such order of the court may be punished by such court.

## Article 20. Remedial Measures and Penalties for Civil Infractions

1. The remedial measures and penalties provided for infractions described in this article shall be determined in particular cases by the Commission. The action shall be based upon: (i) the seriousness of the infraction; (ii) the stage at which it was reported or detected; (iii) whether the same regulated person has engaged in repeated violations; (iv) whether the violator voluntarily reported the violation to the Commission; and (v) what measure is appropriate to remedy or terminate the infraction.
2. The Commission must take one or more of the following actions or impose one or more of the following penalties with respect to an investment fund sponsor, trustee, investment fund portfolio manager or investment fund portfolio management company, investment fund securities broker, or officer or employees of an investment fund sponsor, investment fund portfolio management company, or an investment fund securities broker if the Commission determines that such person is in violation of: (i) a provision of this Law; or (ii) any regulation or order of the Commission issued pursuant to this Law:
  - a. Issue a written warning to comply with the Law;
  - b. Conclude a written agreement with the entity's trustees or board of directors or other governing body to provide for a program of remedial action;
  - c. Issue a written order to cease and desist from such infractions and to undertake remedial actions in a certain timeframe;
  - d. Order that a transaction in the purchase or sale of securities be rescinded and the counterparty to the violator be made whole;
  - e. Prohibit the exercise of voting rights or receipt of interest or dividends in relation to securities acquired in violation of law;
  - f. Enter into a consent decree by which an alleged violator, without admitting or denying the alleged violation, agrees to undertake remedial action that may include restitution of damages incurred by investors from the alleged violation and payment by an alleged violator of the Commission's investigative costs and related expenses, that may include engagement of external auditors or consultants to the Commission;
  - g. Order the disgorgement of profits made or payment of the amount of losses avoided by a violation;
  - h. Impose civil money penalties on the relevant natural or legal persons in an amount of from \_\_\_\_\_ to \_\_\_\_\_, or, for continuing violations, such amount per day for each day that the infraction continues; provided, however, that civil money penalties shall be of similar amount for entities with comparable total assets for the same type of infraction;
  - i. Suspend temporarily or dismiss any administrator of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker from their positions and terminate their receipt of remuneration.
  - j. Impose restrictions on the compensation for services by the legal person or its administrators;
  - k. Revoke the license of a legal or natural person and order a legal person to dissolve under the Company Law; or
  - l. If the Commission determines that an investment fund is insolvent, appoint a receiver to resolve the insolvency in accordance with Article 26.

3. The remedial measures and penalties provided in this article shall not preclude application of other civil or criminal penalties as provided in other legislation.
4. Any civil money penalties or criminal fines imposed in accordance with Articles 20 and 21 shall be allocated:
  - a. first, to victims of the violation, if any, in proportion to their actual financial damages;
  - b. second, to defray the direct costs and related expenses of the Commission of investigation and prosecution, including staff salaries during the time devoted to the case; and
  - c. the balance, if any, shall be paid to the [Treasury].

#### **Article 21. Criminal Offenses**

1. It shall be a criminal offense punishable by a fine of not less than \_\_\_\_\_ or more than \_\_\_\_\_ or imprisonment of not less than one nor more than five years, or both, for any investment fund sponsor, trustee, investment fund portfolio manager, investment fund securities broker, or any officer or employee of an investment fund sponsor, investment fund portfolio management company, or investment fund securities broker or any administrator of such legal person to:
  - a. damage, destroy, alter or falsify books of account or records of such legal person or of a customer of such entity;
  - b. make a false entry or fail to enter material items in the books of account or records of such entity; or
  - c. maintain books of account or records of such entity in a deceptive manner.
2. Upon suspicion that a criminal offense described in paragraph 1 has been committed, the Commission shall refer such matter to the [Public Prosecutor's Office].

#### **Section VI. Miscellaneous Provisions**

##### **Article 22. Segregation of Investment Fund's and Investment Fund's Investors' Assets**

1. An investment fund sponsor, investment fund portfolio management company, an investment fund securities broker, and an investment fund custodian shall segregate the investment fund's and investment fund investors' moneys and securities from their own moneys and securities, in accordance with procedures specified by regulation by the Commission.
2. Assets of an investment fund and investment fund investors that are held by an investment fund underwriter, investment fund portfolio management company, investment fund securities broker and an investment fund custodian are not assets of these securities market intermediaries and must not be used to satisfy liabilities to creditors of such securities market intermediaries by way of lien, sequestration or otherwise in the event of their insolvency or otherwise.

##### **Article 23. Regulatory Determinations**

1. If an investment fund sponsor, investment fund portfolio management company, or investment fund investor represented by an attorney at law believes that the application of the Law to a situation or transaction affecting them requires a regulatory determination, they may submit a letter to the Commission setting forth the facts of their case and their

belief as to the application of the law or any regulation issued pursuant thereto to their case.

2. The Commission within thirty days of the submission of an inquiry that is complete in its judgment shall issue its opinion to the applicant stating whether or not the Commission would take enforcement action with respect to the circumstances indicated.
3. Letters of request and responses of the Commission shall be indexed under the applicable section of the Law or regulations and shall be made available to the public on the Commission's website. The name of the applicant as well as any other information that may identify the applicant or disclose confidential business information shall be redacted from the public file.

#### **Article 24. Private Right of Action**

1. A person who in good faith believes that another person has violated one or more provisions of this Law to their detriment may sue in a court of law for redress.
2. The court may issue an injunction compelling a person to comply with the Law, order rescission of a transaction, order disgorgement of profits made or the amount of losses avoided by a violation, or order a violator to pay damages to compensate the aggrieved party.

#### **Article 25. Imputed Liability**

1. Any person who assists another person in the violation of: (i) a provision of this Law; (ii) any regulation or order of the Commission issued pursuant to this Law; or (iii) any rule of the central securities depository issued pursuant to this Law with knowledge of the violation, shall be liable to the same extent as the other person for the violation.
2. Any legal person that controls another legal person who violates (i) a provision of this Law; (ii) any regulation or order of the Commission issued pursuant to this Law; or (iii) any rule of the central securities depository issued pursuant to this Law shall be liable to the same extent as such violator, unless such controlling person acted in good faith and did not directly or indirectly cause the violation.
3. Administrators of a legal person are liable for the acts of such legal person, unless they demonstrate that they have not been and could not have been aware of the violation.
4. Whenever two or more persons are liable for having knowingly violated: (i) a provision of this Law; (ii) any regulation or order of the Commission issued pursuant to this Law; or (iii) any rule of the central securities depository issued pursuant to this Law, they shall be liable jointly and severally liable. The allocation of liability between or among them shall be governed by the general rules applicable under the Civil Code.

#### **Article 26. Resolution of an Investment Fund Insolvency**

1. Notwithstanding any other provision of law, if the Commission determines that an investment fund is not paying its liabilities as they fall due, the Commission shall appoint a receiver to take possession and control of the investment fund and its assets.
2. The receiver shall have all of the powers and duties of the investment fund sponsor and investment fund trustees. The powers of the investment fund sponsor with respect to the insolvent fund and of the investment fund trustees shall be suspended or terminated by the receiver.

3. The receiver shall: (i) assume management control of the investment fund and all officers, managers, and employees of the investment fund may be dismissed by the receiver and those that remain have no authority to take actions except as approved by the receiver; (ii) revise or terminate any servicing agreements the investment fund may have concluded; (iii) employ any professional advisors or agents to assist in the resolution of the insolvency; and (iv) liquidate the investment fund's assets.
4. Prior and actual trustees, officers, and contract service providers of the investment fund shall take all appropriate steps to safeguard the assets for the benefit of the investment fund, deliver the assets, accounts, and documents of the investment fund and shall cooperate with the exercise of rights and remedies by the receiver.
5. When the assets of the investment fund are liquidated, proceeds of liquidation shall be distributed by the receiver in the following order: (i) first, to the costs and expenses of determination of insolvency by the Commission and any auditors and the costs and expenses of the liquidation, including fees and expenses for services engaged by the receiver; (ii) second, to secured creditors of the investment fund, if any; (iii) third, to the investment fund investors; and (iv) fourth, to any other creditors of the investment fund.
6. Distributions will be made for each priority class *pari passu*, in proportion to the amounts of their claims.
7. Liquidation of investment fund assets shall be in any commercially reasonable manner in the discretion of the receiver but must be completed within one year from the determination of the insolvency by the Commission.

#### **Article 27. Evidence**

1. Notwithstanding any other provision of law, in any civil, administrative or criminal proceeding arising out of or in connection with this Law, electronic data or records and transcriptions or printouts of same of the Commission, an investment fund sponsor, an investment fund, an investment fund portfolio management company, an investment fund securities broker, a stock exchange, the central securities depository, a sub-custodian of the central securities depository or a person who has engaged in a transaction related to any of the foregoing may be admitted in evidence.
2. Admissible evidence in electronic form includes, but is not limited to, computer files and data, server files and data, audio and video recordings, e-mails, SMS messages, telephone records, and facsimile transmissions.

#### **Article 28. Interpretation**

1. The headings of the sections and articles in this Law are used solely for convenience of reference and are not a part of and are not intended to govern, limit, or aid in the construction of any term or provision hereof.
2. Terms used in the conjunctive or disjunctive in this Law may be read vice versa whenever the change is necessary to effectuate the obvious intention of the provision in question.
3. Words in the singular in this Law may be construed as plural and vice versa whenever the change is necessary to effectuate the obvious intention of the provision in question.
4. A masculine pronoun shall include the feminine and neuter pronoun.