

Legal Focus

Amendments to the Law on Securities Market

On March 14, 2008 the Parliament of Georgia adopted changes to the Law on Securities Market (LSM). Changes were adopted as a part of the major legislative initiative aimed at strengthening Financial Sector Competitiveness in Georgia

Strengthening Global Competitiveness of Financial Services in Georgia

Recently a package of laws aimed at enhancing the stability and global competitiveness of the financial services in Georgia was adopted

The Package included a vast number of the laws related to financial services regulation and three new pieces of legislation.

Revisions and amendments are aimed to ease constraints on business and make investment environment in the country more attractive.

Some of the key areas that have been affected and covered include:

- ◆ Financial Services & Banking Supervision
- ◆ Company Law
- ◆ Securities Law
- ◆ Free Industrial Zones & Taxation
- ◆ Customs & Tax Law

Amendments to the Securities Law

Amendments to the securities legislation have been introduced to establish Georgia as an attractive jurisdiction for fund administration and wealth management.

Important changes were made with regard to demutualization of the Georgian Stock Exchange. Prior to the changes, the Stock Exchange was organized as a member based Joint Stock Company with the licensed brokerage companies and settlement banks being the only eligible shareholders. Despite its entrepreneurial/commercial organizational form, the Georgian Stock Exchange was prohibited to distribute profits. These and other changes are further discussed in the present special issue of the Legal Focus.

Revised & New Securities Terms

Several securities terms & definitions have been added and/or modified

Over the years, many of the securities terms contained in the LSM proved unclear and ambiguous. Changes tackled several of those and provided clarifications compliant with the international standards.

Beneficiary owner, registered owner and nominal holding

Definitions of the securities beneficiary owner, registered owner and nominal holder were clarified. The LSM now acknowledges the difference between the registered owner v. registered holder of the securities as well as the concept of the beneficiary which is otherwise estranged to the Georgian legal system. Although it remains to be observed how this distinction between the beneficiary and registered owner is applied and established in practice (due to the low transparency and poor reporting/disclosure culture), these definitions are now in step with the global understanding and securities practice.

Free Float

For the purposes of taxation (further reflected in the Tax Code of Georgia) the definition of the free float was endorsed.

Free Float is determined as a share of the securities of any class issued by the Issuer which does not belong to any of the following: a) 5% or larger share in the securities held by any person (including the Issuer); b) securities

held by the state or local governance bodies, legal persons of public law; c) securities which are in beneficial ownership of the Issuer's management body members and employees. This definition is then applied by the Tax Code of Georgia allowing for certain tax exemptions and benefits for the securities holders of those Issuers, whose securities' free float rate is 25% or more. Benefits extend to capital gain, dividend as well as interest payments related to such securities.

Sophisticated Investor

Definition of a sophisticated investor has been significantly improved and specified. Namely, the definition now extends to the persons who have sufficient experience, assets or income to withstand significant investment losses. Sophisticated investor should be a person supported by significant property, financial institution, director of financial institution or a legal person with the capital of minimum GEL1 Million. Person supported by significant property is one whose proven property exceeds GEL3 Million or annual income over last three years is beyond GEL200,000.

Offering and sale of securities to sophisticated investors does not constitute a public offering. The LSM partially regulates the Funds of Sophisticated Investors where this term is applied.

Financial Institution

Definition of the financial institution has been endorsed. The term covers commercial banks, insurance companies, stock exchange, central

depository, investment fund, brokerage company and other financial services providers. If authorized in developed countries, financial institutions can engage into securities operations in Georgia without additional licensing and/or authorization. Financial institutions qualify as a sophisticated investor. The term bears importance for the tax purposes as in certain circumstances qualification of a financial institution entitles to tax benefits & exemptions.

Demutualization of the Stock Exchange

One of the major conceptual changes endorsed by the amendments is demutualization of the stock exchange in Georgia. Prior, the ownership and membership of the Georgian Stock Exchange was mutual meaning that only the licensed member brokerage companies were the owners of the exchange. The profit of the exchange could not have been distributed.

With the declared interest of a potential strategic investor, the demutualization decision was made and respective changes were reflected in the amendments to the LSM. An exchange can now be a commercial entity and no particular requirement is imposed on its ownership structure.

It has also been clarified that more than one exchange and central depository can exist in the country, however, one exchange can only have one central depository which in turn is prohibited to service any other stock exchange.

Quoting in Foreign Currency

Under the amendments denomination and quoting securities is allowed in any foreign currency, although settlement related to the securities is still technically possible only in local currency and clearing and settlement accounts with the Georgian Central Depository are maintained by the brokerage companies in Georgian Lari only. Law also allows brokerage companies to engage in currency trading, although technically this is not accommodated by the local stock exchange.

Fund of Sophisticated Investors

LSM introduced the notion of the Fund of Sophisticated Investors and few provisions related to the investment funds were added. Unlike the previous edition of the law which was completely silent about the investment funds, new articles distinguish between regulated and non regulated investment funds. Non regulated investment funds can have any organizational form envisaged under the Law on Entrepreneurs. Fund of Sophisticated Investors is a type of the regulated investment fund.

Fund of Sophisticated Investors should file an application with the regulator and can not commence investment operations before registration. Certain disclosure obligations are endorsed and only sophisticated investors can participate.

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Our attorneys have extensive knowledge of the Georgian legislation and international law as well as understanding of business climate in Georgia.

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