

**LEGAL AND REGULATORY ASSESSMENT
FOCUSING ON:
INCREASING THE USE OF INVESTMENT SECURITIES
BROADENING AND DEEPENING THE CAPITAL MARKET
FOR THE MALDIVES**

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ACRONYMS USED

CA	Company Act
CIS	Collective Investment Scheme
CPT	Corporate Profits Tax bill
BML	Bank of Maldives
BPT	Business Profits Tax Act
CMDA	Capital Market Development Authority
forex	Foreign Exchange
GAAP	Generally Accepted Accounting Principles
GoM	Government of Maldives
HDC	Housing Development Company
HDFC	Housing Development Finance Corporation
IFRS	International Financial Reporting Standards
LLP	Limited Liability Partnership
MFLC	Maldives Finance Leasing Company
MIRA	Maldives Internal Revenue Agency
MPAO	Maldives Pension Administration Office
MSD	Maldives Securities Depository
MSE	Maldives Securities Exchange
NAV	Net Asset Value
PA	Partnership Act
PIT	Personal Income Tax bill
SA	Securities Act
SOE	State-Owned Enterprise

PREFACE

This Report is part of technical assistance provided to the Capital Market Development Authority of the Maldives (“CMDA”). Funding is provided by IDA Credit No. 4611-MV; the Implementing Agency is the Maldives Pension Administration Office (“MPAO”).

The overall goal of the assignment is to provide an assessment of the Maldivian legal and regulatory framework to determine how to broaden the use of existing investment instruments and support the introduction of needed new securities.

During the first two weeks of September 2012 I visited Male and held meetings with 22 different organizations, including senior government officials, legal and auditing practitioners, securities issuers, potential issuers, and brokers. My visit was preceded by off-site preparation consisting of document review and research. The details of my off-site work and on-site visit are contained in my report dated September 25, 2012.

With the benefit of the information gathered, I present this Report. It is aimed at:

- Summarizing the types of investment securities under review;
- Setting realistic expectations and practical goals for increasing the use of securities as a financing tool;
- Framing the policy decisions that must be made by the CMDA (and the Government of Maldives at large) and making recommendations in this regard;
- Suggesting an approach to the required legal drafting;
- Identifying the required legal and regulatory changes;
- Offering a summary of actions required; and
- Providing suggested language for amendments to existing Acts and regulations, and in some cases providing new draft rules.¹

I would like to thank the CMDA for its assistance during this process. Special thanks to Makhzoom Saleem and Mariyam Visam, and of course the CEO Fathimath Shafeega.

¹ Many of the issues raised and recommendations made in this Report have been discussed with the CMDA during the on-site. However, given that this Report will be circulated within the Government and to the private sector counterparts I have tried to be as complete as possible in order to support their input and to help the participants reach a consensus.

EXECUTIVE SUMMARY

BACKGROUND

Securities under Consideration. During this assessment we have considered 8 categories of securities for possible use in the Maldives:

1. Classic preferred shares
2. Custom preferred shares
3. Classic corporate bonds
4. Custom corporate bonds
5. Covered bonds
6. Securitizations
7. Investment funds
8. Real estate funds

These 8 categories fall along a continuum in terms of their complexity and level of regulatory risk. The preliminary conclusion is that each has possible application within the Maldives. But the chances of successful adoption vary considerably.

Because the end goal of this assessment is to broaden the use of existing investment instruments and introduce needed new securities, our aim should be to have actual issuances of existing or new types of securities within the next year. Achieving this depends on forming some realistic expectations of which types of securities can actually come to market and then focusing the resources heavily on that outcome.

Potential Issuers. For the Maldives, it appears there are several groups of possible issuers of securities. All but one of the current companies whose shares are listed on the MSE have some Government of Maldives (“GoM”) ownership. Thus the GoM might be expected to support the **State-owned Enterprises** (“SOEs”) in issuing securities, *if this makes sense for the companies themselves.*

There are also a few promising candidates among the **financial institutions**. The Housing Development Finance Corporation (“HDFC”), the Maldives Finance Leasing Company (“MFLC”) and the Housing Development Company (“HDC”) all have (or will have) refinancing needs. The Bank of Maldives (“BML”) can be viewed both as a potential issuer and a potential manager / underwriter of offerings.

The large privately owned companies (“**Pvt Ltd’s**”) might be a good source of issuing corporate bonds. While they may not want to impact voting control by issuing common shares (or contingent voting preferred shares) they may be interested in issuing debt. However, this will require them to submit to the transparency requirements, a fact that should not be underemphasized with them.

Lastly, during my visit, there was much focus on the **resort operators** as potential issuers of securities. While this is possible it is important to recognize that the largest resort operators can and do obtain financing outside of the Maldives. Thus, the target group should be the medium and smaller resort operations.

I also note that the resorts have a strong incentive to match the currency of their liabilities to the currency of their revenues. For this reason I believe the Maldives should allow Maldivian companies to issue securities denominated and payable in foreign currency *but only for those companies that prepare their financial statements and tax reports in that currency.*

Tiers of Attractive Securities. It seems that the 8 types of investment securities under consideration break down into 4 tiers of expected use.

The most promising group of investment securities are **preferred shares and corporate bonds**. These have been issued before. They are more or less “known quantities” to investors and issuers. I have suggested opening up the categories of companies that can issue these securities. I have also suggested adding more custom features to make them more attractive to issuers.

Next I see **covered bonds** as the most likely category for issuance. This recognizes the needs of companies such as HDFC, MFLC and HDC to refinance their portfolios.

I see **investment funds and securitization** as the next level of likely candidates. While investment funds are a solid concept and can be adapted for emerging markets, there simply are not enough issues of securities existing in the Maldivian market to allow diversification; so, one of the main reasons for developing funds does not exist. [The exception to this conclusion would be for the use of money market funds].

Securitization is used by companies that originate a type of asset but have reached their debt-to-equity limits (and thus cannot issue more covered bonds). But this seems far off in the future for Maldivian companies.

I see **real estate funds** as the last possible category. I recognize that there is significant interest in developing real estate funds given the island development business. But the business model of the resort developer is inconsistent with how a real estate fund might be used in the Maldives. If the Maldives was to allow a real estate operation to hold controlling interest in real estate, to not require diversification of holdings, to incur debt for acquisitions and operations and at the same time make it time tax transparent (no taxation at the fund level) then the Maldives would essentially be allowing the current operators to convert to “fund” status and escape corporate tax, negating the recent changes to the Business Profits Tax Act (“BPT”) that imposed taxes on the resorts.

If the diversification / passive management requirements are observed then a real estate fund would need ownership interests in 10 properties (thereby meeting the diversification requirement) and be a passive owner. This is certainly possible. But, the main point is that the fund would be a passive investor, with the fund management not affiliated with the resort ownership or management.

Approaches to Drafting. During the on-site visit, senior government officials made it clear that short, simple Acts are preferred over long, complex ones. The advice was that any new draft act(s) should follow this approach. This was echoed by the legal practitioners, albeit from a different angle. Their complaint was that laws from developed markets -- highly detailed to apply to deep and varied securities markets -- simply were not transferrable to a market such as the Maldives. I completely concur.

With this in mind the suggested revisions to the legal and regulatory regime follow a few themes. Where topics are currently addressed by Acts in place, the suggested new language is to the Act itself. There has been no attempt to remove the jurisdiction over the issue to a regulatory body. I have attempted to keep revision to the Acts minimal. All other suggested revisions are at the regulation level.

LEGAL AND REGULATORY ASSESSMENT

The legal and regulatory assessment is organized in two ways: first by product and then by legal entity type.

By Product

Preferred Shares. Pvt Ltd's should be allowed to issue preferred shares, as long as they are not convertible into common shares or carry contingent voting rights. In order to protect investors, the preferred shares should carry a cumulative dividend and be granted the right to convert into a pre-defined debt security upon a failure to pay.

There are no restrictions on the ability of public companies ("Plc's") to issue preferred shares. But also there is little guidance. In order to avoid a situation where a company might issue preferred shares and then fail repeatedly to pay the dividend I have inserted some mandatory rights for preferred shareholders if the company is overdue on a dividend payment for 180 days.

Company Act ("CA") Article 91 does not address the relative seniority of preferred shareholders. I have included language which specifies the seniority claims of preferred shareholders and the priority of paying preferred share dividends prior to common shares.

CA Article 25 appears to limit the size of any potential offering of securities (although the calculation of the limit is unclear in the Article). I suggest eliminating this. In the alternative I have adjusted the calculation of the limit. Perhaps a better approach would be to impose a debt-to-equity ratio.

There are several variations on the rights that preferred shares may carry which may make them more attractive to issuers and investors. These include payment-in-kind dividends, rights to participate in profits, put rights, call rights and convertibility. While in some jurisdictions it is not necessary to specify that issuers may use these extra features, perhaps for the Maldives it will not hurt to place a section in the CA General Regulation setting these out.

Corporate Debt. Currently Pvt Ltd's are not allowed to issue corporate debt publicly. This restriction seems to be caught up in the idea of preserving the private control of the company. But the restriction is overreaching and can be adjusted to preserve the voting control yet allow the Pvt Ltd to access the securities markets. I have included language in CA Article 23 specifically allowing Pvt Ltd's to sell debentures (publicly or privately) as long as they are not convertible into common shares or carrying actual or contingent voting rights.

Under the current severe curtailment on the use of Limited Liability Partnerships ("LLPs") as a legal entity, they are not empowered to issue debentures. But as described in the section on LLPs below these restrictions are contrary to the best practice use of limited partnerships in more developed markets. As part of significantly liberalizing the use of LLPs I am suggesting that they be allowed to issue debentures.

Currently, the BPT does not allow a tax deduction for interest paid to service debt securities. I have included suggested amendments to place interest paid on corporate debt on the same tax footing as taking a bank loan. This will create "a level playing field" between debentures and bank loans.

There does not appear to be any section that defines the mechanics of corporate bonds. While there are rules on disclosure and listing, there is no real guidance on how a bond is created and maintained. This is particularly important in the area of secured bonds. I do not think the CMDA wants to get into the business of defining what the structure *must* be. But at the same time there is a certain element of "truth in

advertising” that needs to be addressed. When a company sells secured bonds in the Maldives what exactly does that mean? There should be some minimum requirements for labeling it so.

As with the case of preferred shares, there are several variations on the rights that corporate bonds may carry which may make them more attractive to issuers and investors. To make it clear that these features can be used in the Maldives I have included language in the CA General Regulation setting out these alternatives.

Covered Bonds. Similarly, there does not appear to be any language in the Acts or regulations governing the use of covered bonds and it does not appear they are in use in the Maldives today. This is particularly unfortunate as, again, I believe this category of security presents good prospects for this market. I have provided suggested language as an Appendix and believe it would be optimal to include it in the same location as the language on secured bonds.

Collective Investment Schemes. The last three products relate to variations on the theme of collective investment schemes (“CIS”), an area of securities regulation that raises numerous policy issues and regulatory challenges. The threshold question is how “CIS” should be defined.

The draft CIS Bill is modeled on the UK law. It reflects an underlying philosophy of the EU, UK and the US where the regulatory reach is broad and the permitted variations on the product numerous.

My concern is that such an aggressive scope – although completely appropriate for the developed markets – is simply too much for the Maldives to tackle in one step. What we need is “CIS lite” with understandable products, a workable regulatory framework, and achievable supervision. In pursuit of this goal I am suggesting three chapters to be included in one Investment Fund Bill addressing (1) securitizations, (2) securities investment funds, and (3) real estate funds. There will be two main drivers for compliance with the Act. First, there will be prohibitive and mandatory requirements, with penalties for violation. Second, there will be requirements that must be met in order for the fund to achieve tax transparency. This is more along the lines of inducement for compliance.

While the tax treatment for investment funds is critical, there is no need to set it by Act. The Maldives can enable the Maldives Internal Revenue Authority (“MIRA”) to issue regulations providing tax transparency for investment funds, rather than amend the BPT later. The CMDA can take advantage of its authority under Article 60(a) of the Securities Act (“SA”) to adopt a comprehensive regulation on investment funds to cover classic investment funds, real estate funds and securitizations.

By Legal Entity Type

Pvt Ltd’s. The proposed changes in the Acts and regulations concerning Pvt Ltd’s relate to their ability to issue categories of securities and how the terms and conditions will be honored. The mechanics of how Pvt Ltd’s operate has not been revised, except to the extent that it impacts the attractiveness of the securities.

The cumulative impact of the suggested amendments is as follows:

1. Pvt Ltd’s are allowed to issue (1) preferred shares, and (2) corporate bonds (debentures).
2. The transfer of unpaid or partly paid securities is prohibited.
3. The limitation on the number of owners of “shares” has been made clear to relate only to common shares.

4. In order to convert from Plc to Pvt Ltd status the company must certify it has 50 or less owners of its common shares.
5. Language relating to the priority of securities issued by the company has been included in the CA General Regulation.
6. Language relating to foreign currency denomination of preferred shares and debentures has been added to the CA General Regulation.
7. Limitations on the size of offerings in CA Article 25 have been relaxed.
8. The ability to issue preferred shares and debentures with added features has been confirmed.
9. A requirement to pay all dividends and interest on senior securities before paying dividends on common shares has been added.

Plc's. Again, the proposed changes in the Acts and regulations concerning Plc's relate to their ability to issue categories of securities and how the terms and conditions will be honored. The cumulative impact of the suggested amendments is as follows:

1. Unpaid and partly paid securities shall not be transferable.
2. Upon conversion to Plc status, the Pvt Ltd is not required to file a prospectus. The Plc is required to file its latest annual financial statements. A prospectus is required only if the Plc wishes to conduct a public offering.
3. Language relating to the priority of securities issued by the company has been included in the CA General Regulation.
4. Language relating to foreign currency denomination of preferred shares and debentures has been added to the CA General Regulation.
5. Limitations on the size of offerings in CA Article 25 have been relaxed.
6. The requirement to file a prospectus in order to commence business as a Plc (CA Article 43) has been eliminated.
7. The ability of issuing preferred shares and debentures with added features has been confirmed.
8. A requirement to pay all dividends and interest on senior securities before paying dividends on common shares has been added.

Limited Partnerships. Significant adjustments need to be made to the Partnership Act ("PA") to make limited liability partnerships a viable legal entity for use in the capital markets. As the Act now stands LLPs cannot be used as a legal form for investment funds, a fact made very significant given that the legal forms of Trust and Contractual Plan do not exist in the Maldives. In addition, there is no reason why the LLP form should not be used as an alternative to the corporate form for running large businesses.

Thus, I have included several suggested changes to the PA to make LLPs a more attractive business form and a potential issuer of securities:

1. The limitation on the number of partners (now 20) has been removed.
2. The limited partners' liability has been specified as limited to their fully paid-in capital.
3. Proposed changes to the BPT to remove a conflict of law and specify the limited partners are not individually liable for the tax obligation of the LLP have been added.
4. LLPs are allowed to have legal entity managing partners.
5. Only the managing partner is allowed to bind the LLP.

6. The managing partner is liable for debts and other obligations of the partnership.
7. LLPs are allowed to issue debentures.
8. LLP interests are included in the definition of securities.

Trusts. Although the scope of work for this assessment specifically includes a review of the Trusts Bill, I am not sure that this should be a priority for the CMDA. The benefit of having the Trust concept embedded in a jurisdiction's legal regime is that it comes as a package of ideas and practices. The problem for the Maldives is that this package is – in the developed markets where it is used – the product of almost centuries of legal precedent. Thus, in order for the concept to be adopted in the Maldives, the Trust Act would not only need to contain all of the basics of organization and operation, it would also need to record many aspects of trust law that are understood from the related history of court rulings. This is an immense body of law and capturing it succinctly would be a challenge.

Apart from the drafting challenges I am not sure the Maldives urgently needs a Trust Act. The only real application to the 8 categories of investment securities under consideration would be for investment funds. But in the Maldivian context I believe that adjusting the current LLP framework to serve as a vehicle for investment funds is a more promising and cost-efficient approach than creating the Trust concept *ab initio*.

RECOMMENDATION ON REGULATORY ARCHITECTURE

When we read the CA and SA taken together we can see that there are three separate decisions for a company that are bundled into one. The company is “all-in” or not. This creates a lack of flexibility within the system and makes participation by a potential issuer much less attractive.

We should unbundle the process. We should allow companies to convert from Pvt Ltd to Plc and stop there. We should not require a further offering. We should allow both public offerings and private placements after conversion. We should not require listing upon conducting a public offering.

In this latter case, the question becomes: if companies are not required to list after a public offering how do we achieve continuing disclosure to protect investors? The solution lies in delinking the listing decision from the obligation to file continuing disclosure. We do this by creating the concept of a “Reporting Company” and then require all Reporting Companies to file continuing disclosure. We place this requirement in the SA or regulations, not the listing rules. Thus, Reporting Companies that are not listed still have to file the reports. To promote transparency in trading the MSE can be allowed to “admit” securities issued by any Reporting Company for trading on its system.

In this way, the decision to list is delinked from the incurrence of disclosure obligations, yet the securities may still be traded on the exchange at the decision of the exchange, not the issuer. Of course any company may still decide to list, with the prestige that comes with that status.

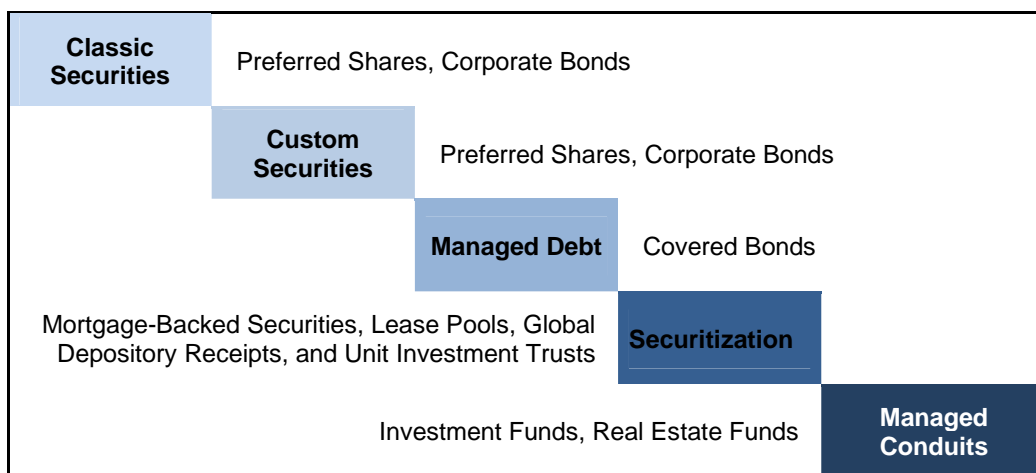
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I. INVESTMENT PRODUCTS UNDER REVIEW

During this assessment we have considered 8 categories of securities for possible use in the Maldives. Two of these categories (preferred shares and corporate debt) have already been issued in the country. There are possible variations for both (so called customized securities). The scope of work listed two other types of securities for consideration: investment funds and real estate funds. I have included two others: covered bonds and securitizations. Thus, the types of securities under consideration are:

1. Classic preferred shares
2. Custom preferred shares
3. Classic corporate bonds
4. Custom corporate bonds
5. Covered bonds
6. Securitizations
7. Investment funds
8. Real estate funds

These 8 categories fall along a continuum in terms of their complexity and level of regulatory risk. Examples of each category are indicated:



The preliminary conclusion is that each of these categories has possible application within the Maldives. The question becomes how does each type operate and what are the implications for Maldivian issuers, investors and capital markets. The basic parameters of each type of security are as follows:²

² I recognize that this Section is somewhat tutorial. It is included here as background for the important policy decisions that must be taken (Section IV) and to help form realistic expectations and goals (Section II).

Classic Preferred Shares

Characteristics. Preferred shares are equity securities. Their issuance is reflected in the shareholders' equity portion of the balance sheet.³ They are issued in units of shares, with the nominal value set per share in terms of a currency (e.g., 150 MRf per share). For classic preferred shares, the nominal value is set in the currency of the home jurisdiction.

The terms and rights of preferred shares are set by company articles of association but follow certain patterns. Upon liquidation of the issuer, the preferred shares are senior to all common shares and junior to all debt holders. Seniority among differing classes of preferred shares is set in the company statute.

Preferred shareholders receive fixed dividends set as an amount in currency or as a percentage of the nominal value (e.g., "15 MRf" or "10% of nominal value"). The preferred dividends must be paid prior to any dividend payment to common shareholders. For classic preferred shares dividends are expressed and paid in the currency of the home jurisdiction.

Preferred shares usually do not carry actual voting rights. However, they may (and should) carry certain rights if the issuer fails to pay the stated dividends. These rights may be either contingent voting rights or the ability to convert the preferred shares into common shares or debt securities. These provisions create a negative consequence to the company for failing to pay the dividend.

Preferred shares are issued to increase the equity capital of the company without impacting voting control. When the shares are sold by the company, entries on the balance sheet for "cash" and "shareholders' equity" are increased.

Dividends paid on preferred shares are treated for tax and financial reporting purposes the same as dividends paid on common shares. Dividends are not usually a tax deductible expense for the issuer as they represent a return on capital.

Key Policy Issues. Classic preferred shares present few difficult policy issues. Because the nominal value and dividends are set in local currency there is no impact to the balance sheet due to foreign exchange fluctuations.⁴ Their seniority among the outstanding classes of securities should be clear in the company articles of association, and supported and enforced by the company and bankruptcy laws.

Key Operational Issues. Similarly, there are few difficult operational issues for using classic preferred shares. The only infrastructure requirement is that the system be able to: (1) announce record date and payment date for dividends; (2) secure accurate data for shareholders of record; and (3) make dividend payments to shareholders on a safe and cost-efficient basis.

³ Preferred shares are used most often by entities with limitations on debt-to-equity ratios (because the preferred shares (as equity) decrease that ratio). They are also used most often by corporations with defined long term capital needs (such as utility companies) where expected earnings from the capital investment can be matched against the stated dividend rate.

⁴ However, this issue can become problematic for custom preferred shares. Please see below.

Custom Preferred Shares

Characteristics. Describing preferred shares as “customized” is a corporate finance distinction, not a legal distinction. Both “classic” and “custom” are types of preferred shares. And, given that they are the same species of instrument under the law, they differ only in the rights they convey to investors.

So, as is the case with classic preferred shares, custom preferred shareholders are equity shareholders. The creation and issuance process for both types of preferred is identical. The accounting for the transaction is identical.

But the policy considerations are more complex. This is the result of the variations on the terms and conditions that may arise.

If the law allows, the nominal value of custom preferred shares may be expressed in local *or foreign* currency.

There is also a great deal of flexibility in how the dividend is defined. The dividend can be “cumulative” or “noncumulative”. Cumulative dividends accrue to the right of the shareholder even if not paid. In other words, if the dividend is not paid for a particular period it “accumulates” and must be paid when dividends are resumed. In the meantime the company’s obligation is carried as “dividends payable” liability. If the dividend is noncumulative and the company fails to make the payment for any particular period then the shareholder’s right is forfeited (although this may trigger certain other rights, please see below).

The dividend can be defined and paid in foreign currency, or paid in local currency but pegged to a value of foreign currency. This raises foreign currency exchange risk for the issuer, but it may make the preferred shares more attractive to foreign investors.

The company statute may specify that the company has the option to pay the dividend “in-kind” which is to say that the dividend may be paid by issuing more preferred shares to the holders. This raises some important -- but not insurmountable -- accounting treatment questions.

The preferred shares may be allowed to “participate” in profits. This means that after the stated preferred dividend is paid, the preferred shareholders also receive a portion of additional dividends paid to the common shareholders. Thus, the preferred shareholders receive their stated return but also participate in the distribution of profits as they are paid to common shareholders in the form of dividends.

Custom preferred shares may also carry the right of the shareholder to “put” the shares back to the company at a defined price and within certain time limits. If specified in the terms and conditions the shares may also be “called” (repurchased) by company at stated prices and within time limits.

Lastly, custom preferred shares may carry conversion rights allowing the holder to convert the shares into specified corporate debt or common shares. And, custom preferred shares may carry contingent voting rights triggered if the company does not pay the required dividend. These latter rights are designed as protection against the company ignoring the preferred shareholders’ dividend rights.

The differences between classic and custom preferred shares can be summarized as follows:

COMPARISON OF CLASSIC AND CUSTOM PREFERRED SHARES		
Elements	Classic Preferred	Custom Preferred
Category:	Equity Security	Equity Security
Units:	Shares	Shares
Nominal value:	In local currency	In local currency or In foreign currency
Seniority:	Senior to Common Shares; Junior to all Debt	Senior to Common Shares; Junior to all Debt
Dividends:	In local currency	In local currency, In foreign currency or In local currency but pegged to foreign currency ----- Cumulative or non- cumulative Payment-in-kind Participating in profits
Voting Rights:	no voting rights	Contingent voting rights upon failure to pay dividend, Actual voting rights
Other Rights:	None	Putable / callable Conversion
Accounting Treatment for Issuer Upon Issuance:	Cash increases; Shareholders' Equity increases	Cash increases; Shareholders' Equity increases
Tax Treatment of Payments from Issuer:	Usually non-deductible	Usually non-deductible
Tax Treatment of Payments to Recipient:	Income to recipient (may be exempt from tax)	Income to recipient (may be exempt from tax)

Key Policy Issues. The more 'exotic' aspects of custom preferred shares can raise regulatory and investor protection issues. While these are not significant I believe that a jurisdiction such as the Maldives should decide these within the legal framework and not leave them to the company statute.

1. The most significant issue is whether par value should be allowed to be denominated in foreign currency. If this is allowed then the line items of “stated capital” and “surplus capital” within the balance sheet will fluctuate between accounting periods. This means that also “shareholders’ equity” (the company’s stated net worth) will also fluctuate due to currency translations.
2. A further question is whether dividends should be allowed to be denominated in foreign currency (akin to a Eurobond issue) or paid in local currency but pegged to a foreign currency. This presents less of an accounting issue than it does a simple foreign exchange (“forex”) risk question.
3. Yet another question is whether contingent voting rights, triggered by a failure to pay the stated dividend, should be a mandatory term.
4. And, lastly, there is a question of whether dividends must be cumulative.

All of these questions raise a philosophical issue of how much the Maldives should to intervene by Act (regulation) into company / shareholder matters.

Key Operational Issues. Custom preferred shares only raise the operational issues as classic preferred shares. Please see above.

Classic Corporate Bonds

Characteristics. Corporate bonds are debt securities. Their issuance is reflected in the “liabilities” portion of the balance sheet. They are issued in units of bonds, with the face value (principal value) set per bond in terms of a currency (e.g., 15,000 Mfr per share).⁵ For classic corporate bonds, the face value is set in the currency of the home jurisdiction.

The terms and rights of corporate bonds are set by company statute and bond indenture but follow certain patterns. Upon liquidation of the issuer, the bonds’ claim to proceeds is senior to those of the preferred shares and common shares. The seniority among differing classes of bonds depends on if they are secured by collateral. Secured bonds are senior to unsecured debt, but only to the extent of the value of the collateral. Any shortfall in liquidation value of the collateral places the secured creditor in the same pool as unsecured creditors for that remaining portion.

Bondholders receive fixed interest payments set as a percentage of the face value (e.g., 10% of face value). Corporate debt usually pays semi-annually. For classic corporate debt interest is expressed and paid in the currency of the home jurisdiction.⁶

Corporate bonds do not carry voting rights. Ownership of the bonds represents a creditor / debtor relationship, not an ownership interest. The interests of the bondholders are usually overseen and protected by a “bondholders’ representative”.

⁵ The usage in the US for corporate bonds is to set face value at \$1,000 per bond.

⁶ This ignores the use of amortized debt which is sold at a discount to face value. I understand that this type of debt is the most widely used in the Maldives today but we are focusing here on creating (increasing the use of) longer term debt securities. Amortized debt tends to be short-term.

Corporate bonds are usually used to increase the “leverage” or “gearing” of profits for the owners. Because interest paid is usually a deductible expense for tax purposes, corporate bonds have an advantage over preferred shares as a funding technique. There are of course prudential limits to a company’s permitted debt-to-equity ratio and the success of the gearing depends on the increased profitability of the company compared to the cost of the interest payments.

Key Policy Issues. Classic corporate bonds present few policy issues. Because face value and interest payments are usually set in local currency there is no forex aspect. Seniority in the bankruptcy setting should be clear and enforceable under the laws, the company’s statute and the bond indenture.

Key Operational Issues. The operational issues for corporate debt are more extensive than for preferred shares.

1. The asset registry must possess the capacity to place pledges on property securing debt issuances, on a timely and cost efficient basis. For the Maldives this is an area that needs to be addressed. Please see “Expectations” section below.
2. The trading system must be able to calculate interest due for trades made between payment dates, and for adding this amount to required purchase monies for clearance and settlement. I am informed by the Maldives Stock Exchange (“MSE”) and Maldives Securities Depository (“MSD”) that this is possible.
3. As with preferred shares, the infrastructure must have the capacity for: (1) announcing record date and payment date for interest payments; (2) securing accurate data for bondholders of record; and (3) making interest payments to bondholders on a safe and cost-efficient basis.
4. The process for foreclosure on pledges in the case of default must be timely and cost-efficient. This is also an area that needs to be addressed for the Maldives. Please see “Expectations” section below.

Custom Corporate Bonds

Characteristics. As with preferred shares, describing corporate bonds as “customized” is a corporate finance distinction, not a legal distinction. “Classic” and “custom” bonds differ only in the terms and conditions they possess.

Holders of custom bonds are creditors of the company. The creation and issuance process for both classic and custom bonds is identical. The accounting for the transaction is identical. But custom corporate bonds raise more complex policy considerations, given their variation on terms.

The face value of custom bonds may be expressed in foreign currency. This creates forex exposure for the issuer.

There is also a great deal of variation in how the interest payment may be defined.

1. Interest can be denominated in foreign currency. Again, this brings forex risk into the picture.
2. The required interest payment can be variable, based on a benchmark rate or index. In a rising rate environment this favors the investor. In a falling rate environment this favors the issuer.

- The bond indenture may specify that the company has the option to pay the interest “in-kind”, which is to say that the interest obligation can be fulfilled by issuing more corporate bonds to the holders. This technique was popular in the 1980’s mergers and acquisitions era.

Custom corporate bonds may also carry a “put” right. More frequently, bonds are “callable” after a certain date from issuance and then at a stated price per bond.

Lastly, custom corporate debt may carry conversion rights. Most frequently this is a right to convert to common shares. The triggering events and conditions can vary widely.

The differences between classic and custom corporate bonds can be summarized as follows:

COMPARISON OF CLASSIC AND CUSTOM BONDS		
Elements	Classic Bonds	Custom Bonds
Category:	Debt Security	Debt Security
Units:	Bonds, Notes [debentures]	Bonds, Notes [debentures]
Face Value of Units:	In local currency	In local currency or In foreign currency
Seniority:	Senior to all Equity	Senior to all Equity
Interest Payments:	In local currency	In local currency or In foreign currency Payment-in-kind Variable rate
Voting rights	No voting rights	No voting rights
Other Rights:	Foreclosure on collateral	Foreclosure on collateral Putable / callable convertibility
Accounting Treatment for Issuer Upon Issuance:	Cash increases; long-term Liabilities increases	Cash increases; long-term Liabilities increases
Tax Treatment of Payments from Issuer:	Usually deductible	Usually deductible
Tax Treatment of Payments to Recipient	Income to recipient (may be exempt from tax)	Income to recipient (may be exempt from tax)

Key Policy Issues. Custom corporate bonds present certain policy issues.

- Denominating debt in foreign currency exposes the issuer to forex translation risk. Yet it may make the security more attractive to foreign investors.
- For a country with currency controls, such as the Maldives, this must be accommodated. Unless the corporate debt issue is large, no adverse impact should be felt.

- Foreign denominated debt is often used for capital expenditures by issuers having matching foreign currency revenues. This is particularly applicable for the Maldives within the tourism sector.

Key Operational Issues. Custom corporate bonds raise the same operational issues as classic corporate bonds. Please see above.

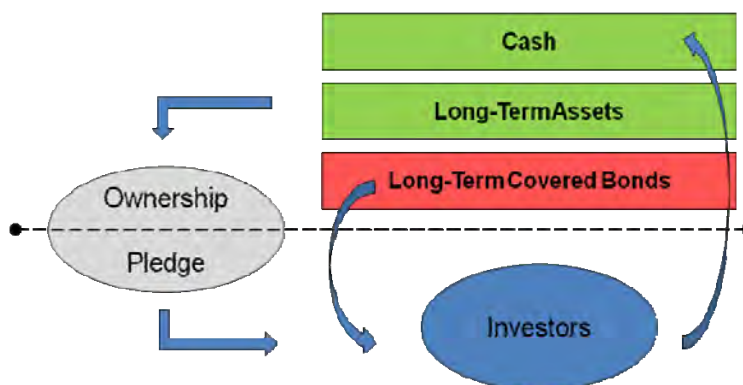
Covered Bonds

Characteristics. Covered bonds are identical to secured corporate bonds except with regard to the structure and operation of the collateral. Covered bonds are secured by a group of assets with maturities matching the maturity of the covered bond. Thus the bonds are secured by a pool of like assets, not a single property.

Moreover, the content of the collateral pool is floating, not fixed. The value of the collateral cover is greater than 100% of the bond obligation (by custom between 110%-120% of the remaining principal value of the bonds). If a component of the collateral pool matures, deteriorates or defaults, it is replaced by new collateral.

The bonds are the direct obligation of the issuer. Ownership of the collateral remains with the issuer, but the pledge is given to the bondholders. There is a collateral pool supervisor (bondholders' representative) who monitors the adequacy of the collateral coverage. Thus, covered bonds are "managed bonds" in that the collateral is monitored and adjusted (compared to "static collateral").

There are variations on how the cover pool is held, including: (1) segregated account, or (2) special purpose vehicles (see also securitization below). This "ring-fencing" gives covered bondholders greater protection in the event of the issuer's bankruptcy. The transaction can be diagrammed as follows:



Key Policy Issues. Given the nature of their collateral, covered bonds raise a few unique policy issues:

- Should the regulatory framework specify the minimum / maximum percentage of collateral pool coverage?
- Should the regulatory framework specify the structure of the pool (e.g., segregated account, escrow or custodian)?
- Should the regulatory framework specify the minimum legal terms for the operation of the pool?

As described below in Section II “Expectations” I believe there is a strong possibility that covered bonds can be used in the Maldivian context and thus these questions are pressing, not academic.

Key Operational Issues. Covered bonds raise the same operational issues as secured bonds, plus two additional needs:

1. The asset registry must be able to remove pledges on defaulted, deteriorated or matured pieces of cover pool assets on a timely and cost efficient basis.
2. At the same time, the asset registry must be able to replace the removed pledges on old collateral with pledges on new collateral deposited into the pool, again on a cost-efficient and timely basis.

The current practices for placing, modifying and removing pledge interests on real estate will bear heavily on the Maldives’ ability to use covered bonds for mortgage refinancing purposes. If the cover pool contains assets other than real estate (such as leases or movable property) then this issue becomes even more important. Please see Section II “Expectations” below.

Securitizations

Characteristics. Securitization is used for the same reason as covered bonds – to refinance long-term assets and create liquidity for the company. However, the structures are very different.

1. Securitization involves a **sale** of the asset, not a **pledge**.
2. A third entity – a special purpose vehicle (“**SPV**”) – is used.
3. The **pool of assets is static**. There is no management.
4. For this reason, securitizations are an example of a “**passive conduit**”.

In this transaction, the company determines the assets to be packaged and securitized. These are usually intangible, financial assets (such as mortgages or leases). Asset securitizers are often originators or servicers of the intangible assets.

Next, the company creates a SPV and places the assets into it. The company takes back – instead of ownership in each, individual asset itself – ownership in the SPV as the collective. This is the packaging phase.

The owner then registers the SPV and its ownership shares at the securities registry. A servicer (administrator) of the SPV is appointed. The shares in the SPV are then sold to investors. This is the fragmentation phase.

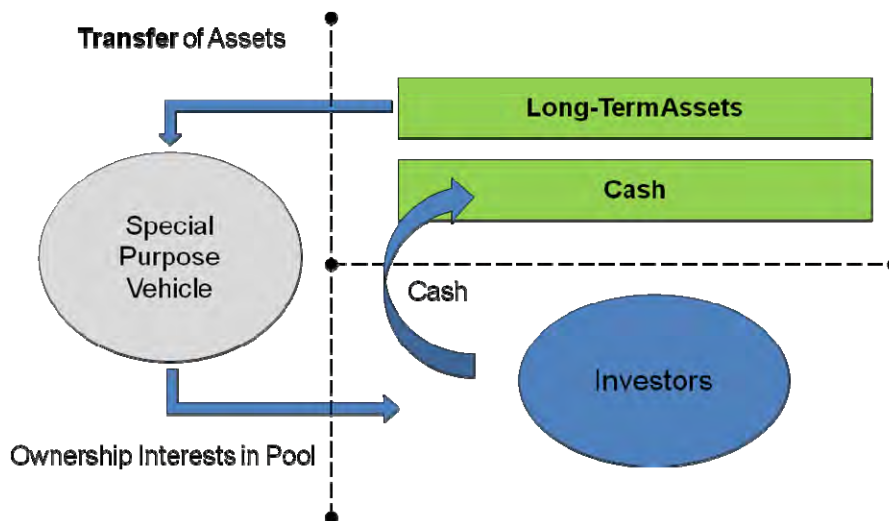
The results of the offering are recorded and title of the SPV shares is transferred to the investors. Proceeds from the offering are received by the issuer.

After the transaction, the holders of SPV shares have no relationship with the creating company. The liquidation / insolvency of the creating company does not impact the SPV or the SPV shareholders’ rights.

The SPV servicer administers payments out of the SPV to the shareholders. The dividend schedule is parallel to the income the SPV receives on its assets.

There is no other management of the SPV. Upon maturity of the assets in the SPV, the proceeds are paid out to the shareholders. Upon the maturity of the last asset, the SPV is dissolved.

The transaction can be diagrammed as follows:



Securitizations can be used for: (1) mortgage-backed securities; and (2) lease pools (by leasing companies to refinance their positions). In my view, both of these applications have near-term promise for the Maldives.

Securitizations can also be used for: (1) Global Depository Receipts, (2) Unit Investment Trusts (pools of debt securities); and (3) index funds. These applications are, in my opinion, further off for the Maldives.

Key Policy Issues. Securitizations raise a few unique policy issues:

1. What should the disclosure requirements be regarding the content of the SPV assets?
2. What grades (qualities) of securitized assets should be allowed for investment funds and the MRPS?
3. What conflict of interest rules should apply when the originator of the assets (e.g., mortgage lender or lessor) is the packager and seller of the SPV shares?

Key Operational Issues. Use of the securitization techniques requires that the asset registry be able to transfer ownership of assets on a timely and cost efficient basis. For real estate in the Maldives this will require court action. For movable property this may require physical possession of title, with a noticed to the ownership registrar.

If the Maldives decides to trade securitized assets as debt instruments (and not equities carrying a dividend) then the system must be able to calculate interest due for trades made between payment dates, as is the case for other bonds.

Note on Business Drivers for Products under Review

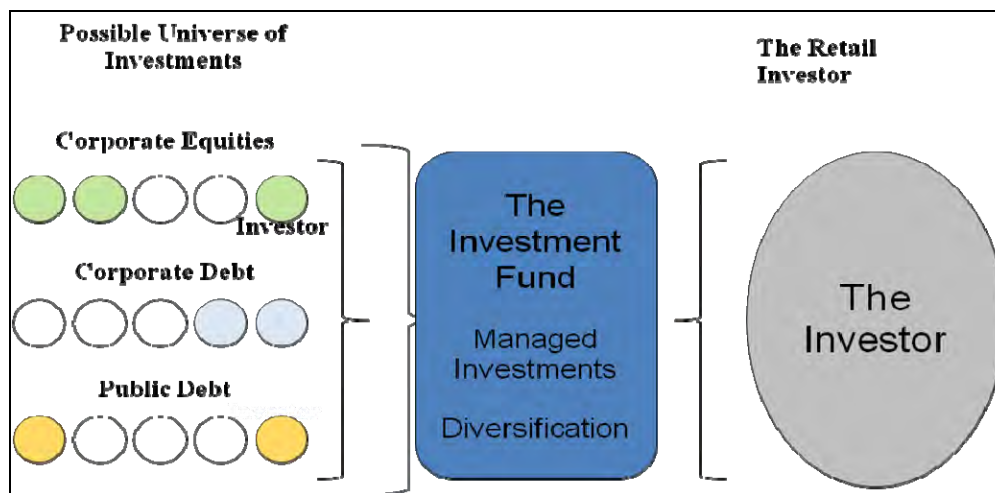
The use of the above 5 categories of securities is driven primarily by the needs of the issuer:

1. Duration of needed finance;
2. Need for leverage;
3. Need to increase equity;
4. Need for flexibility in terms;
5. Need to generate liquidity.

In contrast, the creation of investment funds is driven by the needs of investors:

1. who do not have the time or expertise to sort through numerous investment opportunities, and
2. who need diversification.

In this sense the investment fund stands between the investor and range of investment choices.



So, the prerequisites for the successful creation of Investment Funds are:

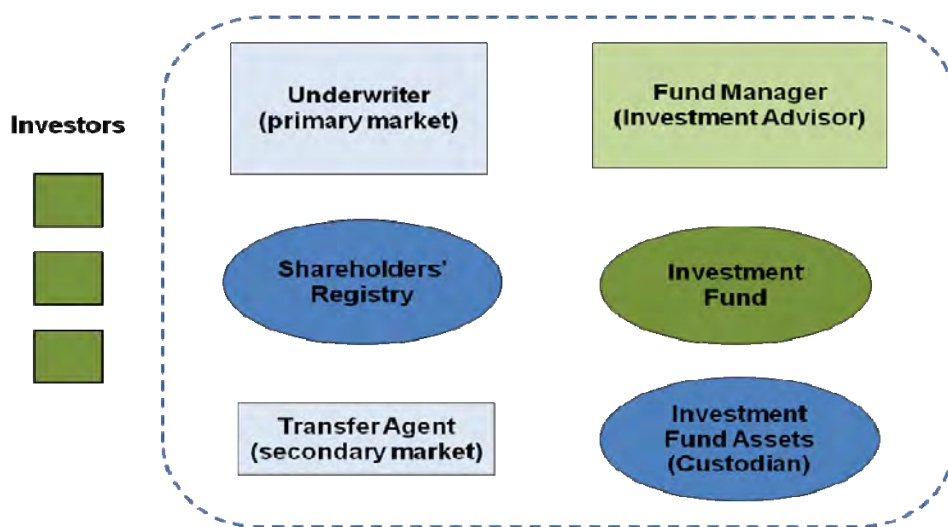
1. A sufficiently large group of interested investors (usually domestic retail or off-shore institutions).
2. A sufficiently broad universe of investment choices.
3. Economies of scale.
4. Enabling infrastructure.

Investment Funds

Characteristics. Investment funds can be formed in many structures and for many purposes. At their core, however, they perform basic functions. They:

1. Take in investors' monies
2. Aggregate the funds
3. Make investments
4. Make distributions on investment gains (pay a return)
5. And at some point, they liquidate

Fund complexes also include certain basic types of entities:



In macro terms, investment funds vary by two key characteristics: (1) the method of selling and redeeming units, and (2) choice of legal entity form.

Selling and Redeeming Units. The method of selling and redeeming units impacts the main relationship between the investor and the fund. There are 3 possible approaches:

1. Open-end Funds:
 - a. Sell units every business day
 - b. Redeem units every business day
2. Interval Funds:
 - a. Sell units every day (or at stated intervals)
 - b. Redeem units only at stated intervals
3. Closed-end Funds:
 - a. Sell units in periodic underwritings
 - b. Do not redeem shares (except upon liquidation)

The choice of method for selling and redeeming units also impacts *how the investment fund's portfolio is managed*:

1. Open-end Funds require high degrees of portfolio liquidity in order to honor daily redemptions. In emerging markets this is a particular concern; it is also a concern in the Maldivian setting.
2. Interval Funds must have sufficient liquidity at the stated redemption periods. This requires advance warning of requested redemptions.
3. Closed-end Funds have the luxury of investing in less liquid assets because they do not redeem.

Choice of Form. The choice of method for selling and redeeming units also impacts the *choice of legal form* (and in this sense the two decisions are closely intertwined).⁷ The generic choices are:

POSSIBLE LEGAL ENTITY FORMS FOR INVESTMENT FUNDS			
	Open-end	Interval	Closed-end
Corporations	Difficult to use this form	Possible	Preferred form
Limited Partnerships	Preferred form	Possible	Preferred form
Trusts	Preferred form	Possible	Preferred form
Contractual Plan	Preferred form	Possible	Can be used but rarely done

But because the Maldives do not possess the legal concept of Trust and do not have a legal heritage supporting the concept of Contractual Plan, the possible use of limited partnerships as a legal form becomes a more pressing near-term consideration.

Limited partnerships can be used in the **open-end, interval** format **if** the partnership agreement allows the number of outstanding units to be adjusted by the general partner (on a daily basis for open-end funds and on a periodic basis for interval funds).⁸

Limited partnerships can be used in the **closed-end** format **if** (1) limited partnership units are included in the definition of security, (2) the exchange rules allow for admission to trading, and (3) the units are placed at the depository for recordation.

⁷ The choice of legal entity form determines which law applies to the management of the fund. Further, the choice of form can determine the tax treatment of the fund. However, for the Maldives, I am suggesting that the MIRA adopt a regulation setting the tax treatment for all investments fund, thus eliminating any uneven tax implications. Please see "L&R Assessment", below.

⁸ The current limitation of 20 partners at PA Article 6 needs to be removed if limited partnerships are to be used as an investment fund form. Please see "L&R Assessment" below.

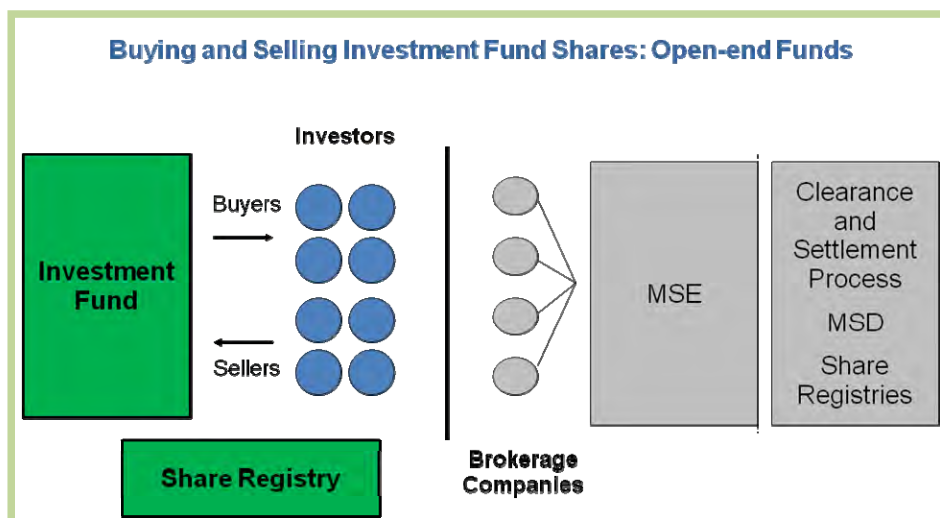
The choice of method for selling and redeeming units also impacts:

1. How the units / shares are priced; and
2. Who handles the ownership records for the units / shares

For Open-end Funds:

- Sale and redemption of units is done directly with investors
- The price is Net Asset Value (“NAV”)
- The capital markets infrastructure is not involved.

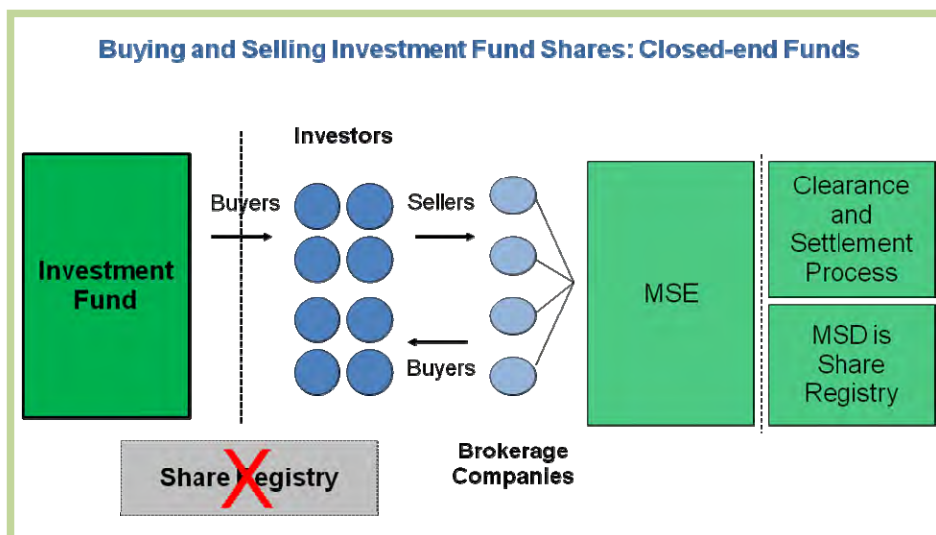
In the Maldivian context this can be diagrammed as follows:



For Closed-end Funds:

- The initial sale of units is made directly to investors at NAV
- However, subsequent secondary transactions are made in the open market
- And the fund is not a party to these secondary market trades
- The open market price is set by supply and demand
- Liquidations and redemptions are performed directly with investors by the fund at NAV

In the Maldivian context this can be diagrammed as follows:



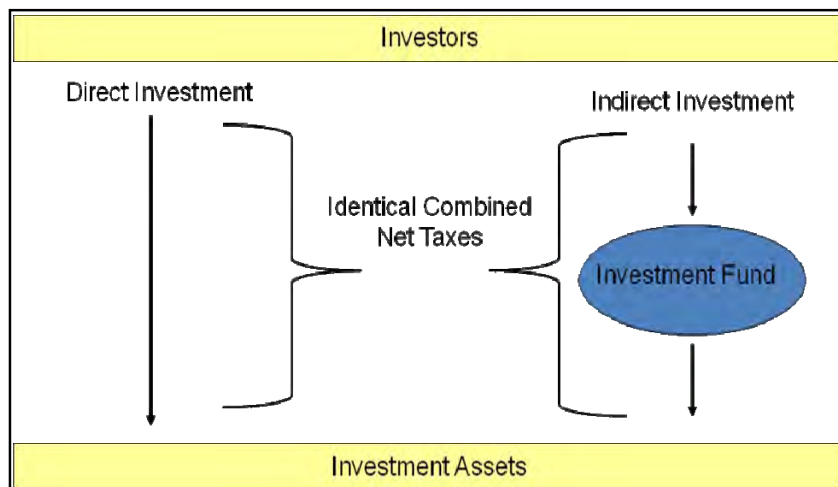
Diversification Requirements. It is common practice for jurisdictions to set criteria for what constitutes diversification:

1. Sometimes this is driven by “truth in labeling”. If a fund wishes to present itself as “diversified” (and therefore lower risk) it must meet the diversification criteria.
2. Sometimes this is driven by “access”. Some jurisdictions only allow “diversified funds” to be offered publicly.
3. Sometimes this is driven by tax policy considerations. In order to enjoy tax transparency (no taxation at the fund level), the fund must meet certain diversification requirements. Please see L&R Assessment, below.

The diversification restrictions tend to be expressed along several lines, for example:

- Maximum use of portfolio assets: “No more than 5% of the fund’s assets may be invested in any one position” or “no more than 10% of the fund’s assets may be invested in the securities of any one issuer”.
- Maximum percentage to be owned: “The fund may not own more than 10% of any class of security”.
- Maximum percentage by security type: “The fund may not own more than 40% in any one type of security”.
- Maximum percentage by liquidity: “No more than 5% of the fund’s assets may be invested in illiquid assets”.

Tax Treatment. Successfully introducing investment funds into a market requires a proper taxation regime. However, it does not require a tax subsidy. Instead, the goal should be to eliminate any discrimination in the tax treatment between direct investment in assets and indirect investment in those same assets via an investment fund. This can be diagrammed as follows:



In the US and most European countries this means that income to the fund is not taxed at the fund level but is instead taxed upon distribution. And, to minimize tax avoidance, the fund is required to distribute profits at least annually. This treatment of the fund as simply a conduit is termed “tax transparency”.

The taxation of Maldivian investment funds should be the same. Please see L&R Assessment below.

Key Policy Issues. Given that the Maldives do not possess the legal concept of investment funds, creating this type of investment vehicle will require the policy-makers to consider several policy and operational issues.

The policy questions include:

1. If and how limited partnerships should be used as an investment fund format;
2. Whether to pursue the contractual plan and/or the trust format;
3. Whether to allow interval funds;
4. How closed-end funds can be incorporated into the MSE/MSD infrastructure;
5. Whether investors should be independently represented in closed-end funds;
6. Given current low levels of liquidity, whether open-end funds should be allowed, and if so, for what types of investment funds;
7. What the tax treatment should be for investment funds (please see L&R Assessment below);
8. Whether diversification should be required; and
9. Whether and how investment fund complex functions can be combined within a single legal entity in order to promote economies of scale.

Key Operational Issues. Given, again, that the Maldives do not possess the legal concept of investment funds, the main question is not so much what the operational rules should be but rather what the enabling environment should look like.

A new Act or comprehensive regulation on investment funds should serve as the primary regulatory authority. It should contain provisions specifying rights and

obligations running between investors and fund management in order to “even out” the use of the various possible legal forms.

Investment funds must also be supported by the proper accounting rules, with the most important aspect being the valuation rules for assets. Valuation of illiquid assets (assets for which no readily available market quote exists) will be an especially important area for the Maldives.

Tax accounting rules should not be applied to investment funds. Instead, financial reporting rules should be applied.

Investment funds must also be supported by the possibility of the legal owner / beneficial owner distinction. Without this arrangement Custodians must rely on contract law or specialized statutes (certainly a less desirable result than an overarching concept). The basic legal premise is that the **legal owner** has title to the property recorded in its name and has the power to dispose of it. The **beneficial owner** enjoys all of the economic benefits from the asset even though it is held in the name of the legal owner. Please see my Memorandum on Legal Owner / Beneficial Owner Concepts for the Maldives (July 31, 2012).

Real Estate Funds

Characteristics. Real estate funds are really just specialized forms of investment funds. But because they present numerous unique issues, they should be analyzed and regulated separately from the classic investment fund.

Real estate funds can be involved in property in several roles:

1. As owner – developer
2. As owner – operator
3. As owner – lessor
4. As owner of lease rights (having acquired lessor rights from another owner)
5. As lessee – operator
6. Passive investor in numerous properties

Choice of Legal Form. However, in all cases the relative illiquidity of these assets drives the allowable legal structures for a real estate fund. Borrowing from the above table we can see that choices become more limited for real estate funds.

POSSIBLE LEGAL ENTITY FORMS FOR REAL ESTATE FUNDS			
	Open-end	Interval	Closed-end
Corporations	Inadvisable	Difficult	Preferred form
Limited Partnerships	Inadvisable	Possible	Preferred form
Trusts	Inadvisable	Possible	Preferred form
Contractual Plan	Inadvisable	Possible	Possible but rarely done

Thus the legal forms allowed for real estate investment funds becomes a key policy issue for any jurisdiction.

Conflicts of Interest. Real estate funds also present numerous potential conflicts of interest which in turn drive the regulatory policies covering them. In the classic investment fund model, the fund manager (investment advisor) cannot have any role in managing the companies held in the portfolio. This is designed to prevent conflicts of interest in making investment decisions (buys and sells) and in valuing the position for reporting purposes. The usual diversification requirements reinforce the passive role of the fund. For example, if the fund may own no more than 5% of the class of securities then there is no control relationship. Neither the fund nor its manager has a role, other than as passive investors.

The practice may be different for real estate funds. Some jurisdictions allow the fund manager to also act as property manager. In fact, the scenario may be that a specialized real estate property management firm decides to form a real estate investment fund as a way of raising more capital, buying new buildings and managing them (expanding its management portfolio). If the diversification requirements are relaxed for real estate funds then not only is the fund manager an active property manager but the fund itself may own a controlling interest (or 100%) in the parcels of real estate held in the fund. In this case both the fund and its manager are active, controlling parties.

It is clear that this latter approach runs contrary to the normal “diversification” rules applied to classic investment funds. Thus, the Maldives has a fundamental choice to make: “shall real estate funds be passive investors among a wide variety of property interests, or shall they be allowed to be owner/managers in a few (or even one) property”? Allowing the latter approach and also providing tax transparency for the real estate funds would appear a poor policy choice. Please see L&R Assessment below.

Tax Treatment. This proper tax treatment is the “flip side of the coin” for the conflicts of interest question. If a fund is allowed to operate one or a few parcels of real estate, holding at least 50% ownership in each, then this is really a real estate company terming itself as a “fund”. Again, there is little diversification advantage for the investors. There is no public benefit, only lost tax revenues.

Use of Debt. Closely related to the ‘management’ issue is whether real estate funds should be allowed to incur debt. It is common practice for jurisdictions to limit a classic investment fund’s ability to incur debt. The limit is usually expressed as a certain percentage of total portfolio assets and then only to meet short-term liquidity needs. Ownership of assets, not leverage, is the goal.

However, the economics of the real estate industry – especially in more developed economies – includes the use of leverage. It may be impractical to invest in real estate successfully without incurring debt. If the chosen model for real estate funds is owner/operator then the use of debt would seem to be unavoidable. If, however, the chosen model is the passive investor in real estate then the incurrence of debt by the fund would appear undesirable.

Valuation of Assets. The proper valuation of real estate for financial reporting purposes is critical. It impacts NAV, yield calculations, reporting to investors, marketing material, and reporting to the regulator. US Generally Accepted Accounting Principles (GAAP) require real estate to be valued at (1) cost, or (2) market value, *whichever is lower*. IFRS allow management to revise the stated value of the real estate based on a good faith estimate.

The GAAP approach fails to recognize legitimate gains in the value of real estate. But, abuse of the IFRS approach leads to “phantom gain”. A NAV increase due to income statement profits (revenues minus expenses) is legitimate. But, a NAV increase due to

a direct adjustment to the balance sheet (direct upward revisions in the stated values of assets) is questionable.

Valuation of real estate has been a particular problem for emerging markets seeking to introduce real estate related securities. Abuse on an industry-wide basis has led to asset price bubbles and collapse of the real estate investment fund sector. The use of qualified, independent appraisers helps mitigate this danger, but does not eliminate it.

Key Policy Issues. All of the above raises several important and crucial policy decision points:

1. Should open-end real estate funds be prohibited?
2. Should interval real estate funds be allowed?
3. Should limited partnerships be allowed to operate as closed-end funds (or as intervals, if allowed)?
4. Should managers of real estate funds be allowed to act as property managers?
5. Stated perhaps another way, should the diversification rules applied to classic investment funds also be applied to real estate funds?
6. If funds are allowed to be active property managers, should they enjoy the tax pass-through treatment normally given to classic investment funds?
7. Should real estate funds be allowed to incur debt as part of their operations?
8. Should the incurrence of debt be limited to acquisitions of properties (and not for ongoing operating expenses)?
9. Should debt-to-equity limits be imposed?
10. What valuation rules for real estate should be adopted? Should the Maldives simply continue to apply IFRS as for other entities or should specialized rules be adopted? If specialized rules are adopted, will this create a disparity between stated values for real estate held by funds and real estate held by others?
11. Should real estate funds be required to use qualified, independent appraisers to provide estimates (or review management's valuations)?

Key Operational Issues. Given that the Maldives is considering whether and how to enable real estate funds, it is difficult at this stage to identify the operational issues involved. Once the policy issues have been determined it will be much easier to identify operational and infrastructure needs.

II. EXPECTATIONS AND GOALS

This assessment presumes an end-goal: broadening the use of existing investment instruments and introducing needed new securities. The overall desired result is to make the Maldivian capital market a stronger, deeper part of the financial system.

In view of this, I believe the practical goal of this exercise, and all of the activities surrounding it, should be to have actual issuances of existing or new types of securities within the next year. I believe that success in achieving this goal depends

on forming some realistic expectations of which types of securities can actually come to market and then focusing the resources heavily on that outcome.⁹

Potential Issuers

For the Maldives, it appears there are several groups of potential issuers.

State-owned Enterprises. The anecdotal evidence is that the SOEs currently operate as an informal financing club. They lend to and borrow from each other, and come to the banks only as needed. It is unclear whether any particular SOE is being disadvantaged by this practice.

At the same time, it appears that the GoM has an interest in supporting the development of the capital market. All but one of the current companies whose shares are listed on the MSE have some GoM ownership. Thus the GoM might be expected to support the SOEs in issuing securities, *if this makes sense for the companies themselves*. While an SOE decision to issue securities – driven only by political pressure -- might be expedient I do not believe we should seek such artificial participation. It is not a sustainable approach.

Thus, for the SOEs it seems that issuing preferred shares or corporate debt (rather than common shares) might be a good opportunity. To the extent that the SOE is formed as a Pvt Ltd then the Company Act should be adjusted to allow this. If the SOE is government chartered, either an adjustment to the charter or a conversion to Pvt Ltd or Plc would be required.

Financial Institutions. The potential financial institution issuers fall into roughly three groups, the Bank of Maldives, the branches of the foreign banks and the specialized nonbank financial institutions such as the Housing Development Finance Corporation, the Maldives Finance Leasing Company and the Housing Development Company. To me, this latter group is the most promising.

HDFC and HDC are originators of mortgages. MFLC originates leases. All have a potential need to refinance their portfolios, depending on their liquidity needs. All could use secured bonds, covered bonds or securitization depending on their leverage ratios and whether they want to keep their loans (leases) on the balance sheet or off.¹⁰

Their future ability to come to market should not depend on whether they are Plc's, Pvt Ltd or government chartered. As long as the transparency of the offering is sufficient and the issuers will be required to supply ongoing periodic reports they should be allowed to come to market.

⁹ This is more than a theoretical, lofty aim; it is driven by a pressing, practical need. The MRPS lacks a sufficient supply of domestic investable instruments for the monies coming into the system. Without more choices for responsible domestic investment, the pension fund's assets will continue to be invested in bank term deposits and/or T-bills, or move to foreign investment. Both are undesirable outcomes.

¹⁰ At the time of my on-site HDFC had a prospectus in processing at the CMDA for an issuance of secured bonds. MFLC has not reached a liquidity constraint yet on its balance sheet but will need to consider covered bonds or securitization when it does. HDC would like to package its social housing mortgages but the pricing appears prohibitive. At 6% yield the bonds would not be competitive after packaging. At the same time HDC needs more operating funds.

The Bank of Maldives can be viewed both as a potential issuer and a potential manager / underwriter of offerings. To the extent that the BML has reached its lending limits with any customer it still has a strong incentive to maintain that relationship. By managing a debt or preferred offering for the customer the BML helps it obtain the financing it needs while not losing the client to another bank.¹¹

If the BML needs additional funding it might consider coming to the market with a debt offering. If it finds itself liquidity constrained it might consider a covered bond offering or securitization (I do not think the BML has reached this stage). If the GoM decides to open up the equity participation the BML might issue common or preferred shares. [I think the local professionals are in a far better position to gauge these likelihoods than me.]

I do not think the branches of the foreign banks are likely issuers of securities in the Maldives, unless they have capital expansion needs that they wish to finance in matching currency.

Large Privately-owned Enterprises. The large Pvt Ltd's might be a good source of issuing corporate bonds. While they may not want to impact voting control by issuing common shares (or contingent voting preferred shares) they may be interested in issuing debt. However, this will require them to submit to the transparency requirements, a fact that should not be underemphasized with them.

Currently the Company Act prohibits the public offer of debt by Pvt Ltd's. This needs to be revised. Please see the L&R Assessment, below.

Resort Operators. During my visit, there was much focus on the resort operators as potential issuers of securities. While I think this is possible it is important to recognize their unique status within the market. Namely, it appears that the largest resort operators can and do obtain financing outside of the Maldives. Thus, the target group must be the medium and smaller resort operations.

Secondly, the resorts have a strong incentive to match the currency of their liabilities to the currency of their revenues. This means issuing debt in USD, Euro or another foreign currency.

For this reason I believe the Maldives should allow Maldivian companies to issue securities denominated and payable in foreign currency *but only for those companies that prepare their financial statements and tax reports in that currency*. In other words, if the company uses a foreign currency as its "operating currency" under the reporting and tax rules, then preferred shares and corporate debt should be allowed in that currency. For companies reporting in MRf, I believe the accounting issues raised by cross currency denomination are simply too troublesome to allow foreign denomination at this time. And I am not sure these companies really need it. Please see L&R Assessment below.

Investor Demand

Investor demand is hard to gauge. At the retail level it would appear that the damage caused by the MTDC offering and subsequent collapse is lingering. It is not clear what level of marketing would be required to have the public come in again to a securities

¹¹ During the on-site BML management mentioned a private placement of preferred shares that was in advanced planning stages.

offering. Several of the persons interviewed during the on-site stated that both preferred shares and bonds were the most attractive of all of the alternatives under consideration because they had been issued before and would be better understood by potential investors.

There does appear to be pockets of liquidity at the institutional level and these could be a driver for an offering. Still, in order to have a subsequent liquid trading market for the securities some level of retail participation is needed.¹²

System and Infrastructure impediments

Several persons interviewed during the on-site cited the lack of a consistent and timely judicial system as an impediment to enforcing investor rights. I agree that weaknesses in rule of law will be an obstacle to new offerings. However, this problem cannot be solved by a legal and regulatory assessment and subsequent suggested amendments to Acts and regulations.

Similarly, it appears that the lack of a computerized and centralized pledge registry for movable property and the use of the courts to record pledges of real estate are operational drawbacks. I have attempted to address this in the proposed rules for secured debt, covered bonds and securitization but these are only stopgap, secondary alternatives to adopting a greatly improved infrastructure.

Taxation - Potential Role of Foreign Investors

If the Maldives wishes to attract foreign investors it needs to adopt a taxation scheme that does not penalize their involvement. The existence of double taxation for foreign investors – once in the Maldives and then again in their home country – will present a significant deterrent to foreign investment.

In some ways the Maldives' tax regime is the inverse of what might be expected elsewhere. Here the taxation occurs at the entity level but none at the personal level.¹³ In other jurisdictions one might expect to find tax transparency at the entity level but taxation upon the recipients of the profits.

The Maldives has other experienced, advisors with regard to the tax system and I do not wish to go too deeply into the subject. But suffice it to say that if foreign investors are taxed in the Maldives with no chance to reclaim the tax paid then there is a significant obstacle to bringing in outside funds. This point relates both to the purchase of corporate securities and any investment in investment funds.

Expected Usages of Existing and New Securities

In view of all of the above, it seems that the 8 types of investment securities under consideration break down into 4 tiers of expected use.

¹² This point relates back to the needs of the MRPS. Not only does it need quality domestic investable instruments it also needs (in an ideal world) a liquid secondary market to help it value those positions and to exit as desired.

¹³ I am aware of the pending Personal Income Tax bill and have commented separately on some of its provisions in Memoranda dated September 8th and 9th.

Tier 1. The most promising group of investment securities are **preferred shares and corporate bonds**. These have been issued before. They are more or less “known quantities” to investors and issuers. The amount of public and issuer education required for new issuances should be minimal.

The suggested amendments to the Acts and regulations as detailed in the L&R assessment below will make these categories even more attractive. I have suggested opening up the categories of companies that can issue these securities. I have suggested adding more custom features to make them more attractive to issuers, including the possibility of foreign currency denominated securities. In short, I have proposed changes that will adapt these securities better to what I understand are the issuers’ needs, without sacrificing investor protection.

Tier 2. Next I see **covered bonds** as the most likely category for issuance. HDFC is already structuring their refinancings with their institutional owners in a covered debt format (albeit mortgage by mortgage, not as a managed pool). It would be a small step to adopt the covered bond format and sell these in the Maldivian markets. MFLC, when it reaches its portfolio limits, should also be interested in covered bonds. If the rate problems can be fixed for HDC it too would be an issuer.

Tier 3. I see **investment funds and securitization** as the next level of likely candidates.

While investment funds are a solid concept and can be adapted for emerging markets such as the Maldives, an ingredient is missing in this equation. Just as the MRPS lacks a sufficient supply of investable instruments so too would any classic investment fund. There simply are not enough issues of securities existing in the Maldivian market to allow diversification and so one of the main benefits of a fund would not exist.

The main exception to this conclusion would be for the use of money market funds. There does appear to be a sufficient supply of T-bills and bank term deposits to fill this type of fund. It also would allow retail access to the T-bill issuances on a time and cost efficient basis.

Securitization is used by companies that originate a type of asset but have reached their debt-to-equity limits (and thus cannot issue more covered bonds). But this seems far off in the future of HDFC, MFLC and HDC. Securitization could be used to bring foreign securities onto the Maldivian market (in the form of GDRs) but this transaction needs a sponsor. The same holds true for using securitization to form an index fund.

Tier 4. I see **real estate funds** as the last possible category. I recognize that there is a great deal of interest in developing real estate funds and real estate investment trusts especially in light of the island development business. But the business model of the resort developer is inconsistent with how a real estate fund might be used in the Maldives. Perhaps the best way of describing this is as follows:

COMPARISON OF REAL ESTATE FUND MODELS		
Topic	Active Management Model	Passive Management Model
Controlling ownership	Allowed	Not Allowed
Diversification	None	Required. Must have 10 properties to meet diversification requirements.
Use of Debt	Incurring debt allowed for acquisitions and operating expenses	Incurring debt not allowed
Management Role of Fund	Active	Passive
Tax Treatment	?	Tax Transparent (Fund does not pay profits tax; tax is imposed on recipients)

If the Maldives was to allow a real estate operation to hold controlling interest in real estate, to not require diversification of holdings, to incur debt for acquisitions and operations and at the same time make it time tax transparent (no taxation at the fund level) then what the Maldives would essentially be allowing is for all of the current operators to convert to “fund” status and escape corporate tax, negating the recent changes to the Business Profits Tax Act that imposed taxes on the resorts.¹⁴

If the active / passive management distinction is observed then the only application it would have in the Maldives resort context would be if the fund owned interests in 10 properties of equal value (thereby meeting the diversification requirement. This is certainly possible. But, the main point is that the fund would be a passive investor, with the fund management not affiliated with the resort ownership or management.

A real estate fund might also be possible outside of the resort context. For example a fund could be in the business of buying office spaces and leasing them out. So this type of investment fund should not be ignored or omitted.

Although the probability of using each of the 8 categories of securities varies considerably for the Maldives, the L&R Assessment below covers all 8 categories under consideration and supplies suggested amendments to Acts / regulations (and new regulations) to implement them.

¹⁴ If the goal is to open up financing alternatives for the resort operators, the better approach would be to enable the use of preferred shares or corporate bonds. Providing a huge tax loophole for the resort operators by allowing them to qualify as tax exempt “funds” is against the public interest.

III. DRAFTING APPROACHES

When creating (or amending) a legal regime covering securities and corporate finance a simple but important question usually arises: which provisions shall be set by Act and which may be set by regulation? My own view is that it is preferable to have the majority of the content defined in the rules, as opposed to the Acts themselves. Setting the operational aspects in the rules allows the regulator to react quickly, making adjustments as needed. In contrast, if the securities and corporate finance laws themselves are highly detailed and specific, making adjustments requires amendments to those Acts, which can be a time-consuming process.

At the same time, of course, there are certain policy issues and decisions which should be made only by the Majlis. We must be careful to respect its prerogatives and not attempt to take on decisions rightfully reserved for it. There are 5 factors at work which impact the drafting allocations.

1. During the on-site visit, senior government officials made it clear that short, simple Acts are preferred over long, complex ones. The advice was that any new draft Act(s) should follow this approach. My sense was that these government officials were conveying their own preferences as well as those expressed by certain members of the Majlis.
2. This was echoed by the legal practitioners, albeit from a different angle. Their complaint was that laws from developed markets -- highly detailed to apply to deep and varied securities markets -- simply were not transferrable to a market such as the Maldives. I completely concur in this complaint.
3. The CMDA has broad rule-making authority under SA Article 60(a) which it has used in the past.
4. There are General Regulations in place under the Company Act and Partnership Act which can be amended as necessary.
5. The MIRA has indicated its agreement to seek authority to adopt -- by rulemaking -- the policy on taxation for collective investment schemes.

In view of all of the above I have followed a certain approach when drafting the proposed amendments and new legal documents necessary to achieve our goals:

1. In the case of topics currently addressed by Acts in place, I have suggested revised language to the Act itself; I have not attempted to remove the jurisdiction over the issue to a regulatory body.
2. For amendments to Acts, I have attempted to be minimalist, yet achieve the goal
3. For issues related to regulations in place, I have suggested revised language for that rule; I have not attempted to write a separate regulation.
4. For issues not addressed by an Act in place, and not related to an existing regulation, I have supplied the body of the text; I will leave it to the CMDA and GoM to determine which form it should take.¹⁵

¹⁵ While it may be expedient to take advantage of the CMDA's broad rule-making authority, I have not included topics or issues that should in fact be covered by an Act. "Stretching"

(Footnote continued)

IV. LEGAL AND REGULATORY ASSESSMENT

This legal and regulatory assessment is limited to matters related to increasing the use of existing securities and/or introducing new categories. It is not an overarching review of the Maldives' corporate and securities regulatory regime. In cases where I have identified systemic or infrastructure issues, I have summarized these in the last section of this Report. I also include there some major issues identified in the Acts or regulations impacting corporate or partnership operations.

Products

This section organizes my findings and suggestions by product.

PREFERRED SHARES

Ability of Pvt Ltd's to Issue Preferred Shares. Currently Pvt Ltd's are not allowed to issue preferred shares publicly. There is also no mention of private offerings of preferred shares. Both should be allowed, with limitations.¹⁶

Because Pvt Ltd's are not allowed to have more than 50 common shareholders, issuing preferred shares convertible into common shares could result in a violation of that numerical limit. Thus, this could be used as a backdoor method to increase the number of virtual shareholders above the limit. While one could argue that this would require the Pvt Ltd to convert to Plc status, it raises a question of what would happen if the Pvt Ltd did not. To avoid this I have placed in the General Regulation a prohibition on Pvt Ltd's issuing preferred shares convertible into common shares.

Similarly, issuing preferred shares with contingent voting rights that can be exercised upon the failure to pay the dividend would raise the question of expanding control beyond the 50 owners. While this is a proper protection for investors it would seem to run contrary to the intent behind the Pvt Ltd concept. For this reason I have placed in the CA General Regulation a prohibition on Pvt Ltd's issuing preferred shares with contingent voting rights. Instead the preferred shares must carry a cumulative dividend and be granted the right to convert the preferred shares into a pre-defined debt security upon a failure to pay.

Ability of Plc's to Issue Preferred Shares. There are no restrictions on the ability of Plc's to issue preferred shares but at the same time there is not much guidance in the CA or CA General Regulation on the possible terms and conditions. In order to avoid a situation where a company might issue preferred shares and then fail repeatedly to pay the dividend I have inserted some mandatory rights for preferred shareholders if the company is overdue on a dividend payment for 180 days.

Foreign Currency Denomination. Denominating preferred shares in foreign currency may make them more attractive for certain issuers. However, if this is allowed and if the company reports in MRf then the line items of "stated capital" and "surplus capital"

that authority too far could in fact result in having it limited by the Majlis in the future. In addition, I have not suggested a new CMDA rule where the subject matter applies to all companies, not just listed companies. In these cases I have suggested amendments to the General Regulations adopted under the Company Act or Partnership Act.

¹⁶ Given that the categories of permitted securities are expanding, I have converted many references to "shares" within the Company Act and CA General Regulation to "securities".

within the balance sheet will fluctuate between accounting periods. In order to eliminate this danger area, yet allow this aspect under proper circumstances, I have added language to the CA General Regulation allowing it only for companies whose “operating currency” is in a foreign currency and therefore issues its financial statements and tax reports in that currency.

Seniority. CA Article 91 does not address the relative seniority of preferred shareholders. I have included language which specifies the seniority levels of claims by each type of security holder.

I have also included language at CA Gen Reg Article 9+ to specify the priority of paying interest and dividends due, and the sources of dividend payments.

Limitation on Size of Offering. CA Article 25 appears to limit the size of any potential offering of securities (although the calculation of the limit is unclear in the Article).¹⁷ I suggest eliminating this. In the alternative, I have adjusted the calculation of the limit.

Perhaps a better approach would be to limit the debt-to-equity ratio. In this way the size of any potential offering is not limited; a company can get big fast. But the amount of leverage (gearing) is capped. My numerical limit is not objective and can be revised as the policy-makers see fit.¹⁸ The suggested language does not prohibit taking on any kind of liability, only issuing debt securities above the ratio.

Allowing Other Rights and Enhancements. As discussed above in Section I, there are several variations on the rights that preferred shares may carry which may make them more attractive to issuers and investors. These include payment-in-kind dividends, rights to participate in profits, put rights, call rights and convertibility. While in some jurisdictions it is not necessary to specify that issuers may use these extra features, perhaps for the Maldives it will not hurt to place a section in the CA General Regulation setting these out.

SUMMARY OF ACTIONS TO ENCOURAGE USE OF PREFERRED SHARES	
Needed Action	Location of Adjustment
Allow Pvt Ltd’s to issue preferred shares	CA Article 23(a)-(c) CA Gen Reg Article 5+
Set minimum investor protection for preferred shares issued by Pvt Ltd’s and Plc’s.	CA Gen Reg Article 5+
Allow foreign currency denomination of preferred shares for issuers reporting in that foreign currency	CA Gen Reg Article 5+

¹⁷ If the impact of the Article is to require a 1 to 1 ratio, I have to say I am not sure how this limit affects companies such as HDFC which must refinance its mortgages.

¹⁸ There is also an option to remove both the offering size limit and the debt-to-equity ratio limit. In developed countries this is not addressed in the law but instead left to market forces. Some emerging markets where I have worked have abandoned the debt-to-equity limits that previously existed in their company laws. For the Maldives it is a question whether the policy-makers believe market forces are sufficient and disciplined enough to impose a rational cap.

Eliminate the securities offering size limit OR revise the calculation OR impose a debt-to-equity ratio limit	CA Article 25
Establish the priority of preferred shares in a wind-up situation and priority of dividends	CA Article 91 CA Gen Reg Article 9+
Specifically allow payment-in-kind dividends, rights to participate in profits, put rights, call rights and convertibility.	CA Gen Reg Article 5+

CORPORATE DEBT

Ability of Pvt Ltd’s to Issue Corporate Debt. Currently Pvt Ltd’s are not allowed to issue corporate debt publicly. This restriction seems to be caught up in the idea of preserving the private control of the company. But the restriction is overreaching and can be adjusted to preserve the voting control yet allow the Pvt Ltd to access the securities markets. I have included language in CA Article 23 specifically allowing Pvt Ltd’s to sell debentures (publicly or privately). I have inserted language at CA Gen Reg Article 5+ to prohibit the sale by Pvt Ltd’s of debentures convertible into common shares or carrying actual or contingent voting rights.

Ability of LLPs to Issue Debentures. Given the current severe curtailment on the use of LLPs as a legal entity, they are not empowered to issue debentures. But as described in the section on LLPs below these restrictions are contrary to the use of limited partnerships in more developed markets. As part of significantly liberalizing the use of LLPs I am suggesting that they be allowed to issue debentures. I have added language to the Partnership Act after Articles 11 and 40. I have also included as an Appendix suggested implementing language for the Partnership General Regulation.¹⁹

Foreign Currency Denomination. Because denominating debentures in foreign currency does not raise impacts to line items within “shareholders’ equity” of the balance sheet (the company’s stated net worth) I have inserted into the CA General Regulation permission for companies to issue debentures in foreign currency. This will of course raise forex risk.

Seniority. CA Article 91 does not address the status of secured versus unsecured creditors. I have included language which specifies the seniority levels of debenture holders. I have also included language at CA Gen Reg Article 9+ requiring that interest on debt obligations be paid prior to paying any dividends.

Deduction for Interest on Corporate Debt. Currently the Business Profits Tax Act does not allow companies to deduct the interest they pay to service debt securities. I suggest revising BPT Article 11(a)(5) as follows:

11. (a) Without prejudice to the generality of Section 10(a), in computing a Person’s taxable profits for a tax year, a deduction shall not be allowed in respect of:

[(1)-(4) omitted]

¹⁹ I recognize that this concept may be difficult to achieve, simply because it is very different from the current understanding and application of LLPs in the Maldives. In view of this I have structured the language so that if it is not adopted then this will not damage the use of LLPs as a vehicle for investment funds.

- (5) interest if and to the extent that it is payable at a rate exceeding 6% (six percent) per annum, except interest payable to a bank or financial institution approved by the MIRA, or made to service debt obligations relating to a debt security issued, or guaranteed by, the taxpayer, provided however that the debt security is listed or admitted for trading upon a securities exchange licensed by the Capital Markets Development Authority for operation within the Maldives;

(suggested added language underlined)

This will place interest paid on listed or admitted corporate debt on the same tax footing as taking a bank loan. As such it creates “a level playing field”; the tax incentives are equal. The language relating to “listed or admitted” is designed to enable the ‘admitted for trading’ concept described below.²⁰

Defining the Mechanics of Corporate Bonds (Unsecured, Secured and Guaranteed). I have not seen any section that defines the mechanics of corporate bonds. While there are rules on disclosure and listing, there is no real guidance on how a bond is created and maintained. I think some language may be helpful.

This is particularly important in the area of secured bonds. There are a variety of possible structures and I do not think the CMDA wants to get into the business of defining what the structure *must* be. But at the same time there is a certain element of “truth in advertising” here that needs to be addressed. When a company sells debt they describe as “secured bonds” in the Maldives what exactly does that mean? There should be some minimum requirements for labeling it so.

There are 2 possible places to put such language. It could be included in the CA General Regulation. Since the CA applies to all companies and both private and public offerings, this could be a logical place after CA Gen Reg Article 5. If this is viewed more as a truth in labeling for public offerings then a logical place might be a Schedule 1 of the Regulation on the Issuance of Securities. I attach proposed language as an Appendix to this Report. The main points are:

- The bonds are created using a bond indenture;
- A bondholders representative must be appointed
- The bondholders' representative has powers to require the issuer to cure the lapse of collateral or guarantees, to investigate apparent violations of the bond indenture, and to take actions upon default.
- The process for taking a pledge interest in collateral is adjusted for the Maldives registry environment
- Bonds must be dematerialized and registered at the MSD

This is suggested language and terms and can be discussed and revised as the CMDA sees fit.

²⁰ In the Section below on “Regulatory Architecture” I suggest creating the concept of a “reporting company”. This in turn supports the concept of a security being “admitted to trade” on an exchange. This approach disconnects incurring the disclosure obligation from the listing decision, by requiring all reporting companies to file periodic reports. The company’s securities can then either be listed by the company or admitted to trade by a decision of the MSE.

Allowing Other Rights and Enhancements. As with preferred shares, there are several variations on the rights that corporate bonds may carry which may make them more attractive to issuers and investors. These include payment-in-kind interest, variable rate interest, put rights, call rights and convertibility. To make it clear that these features can be used in the Maldives I have included language in the CA General Regulation setting these out.

SUMMARY OF ACTIONS TO ENCOURAGE USE OF CORPORATE DEBT	
Needed Action	Location of Adjustment
Allow Pvt Ltd's to issue debentures, provided they are not convertible into common shares or carry voting rights	CA Article 23(a)-(c) CA Gen Reg Article 5+
Allow LLPs to issue debentures	PA Article 11+ Partnership Gen Reg
Allow foreign currency denomination of debentures	CA Gen Reg Article 5+
Establish the priority of debenture payment in a wind-up situation and for interest	CA Article 91 CA Gen Reg Article 9+ PA Article 11+ and 40+
Allow interest paid on corporate debt to be deductible for tax purposes	BPT Article 11(5)
Establish minimum requirements for describing an instrument as a "corporate bond" and for describing it as "secured" or "guaranteed"	New text set out in Appendices
Specifically allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility	CA Gen Reg Article 5+ New Text at PA Gen Reg

COVERED BONDS

There does not appear to be any language in the Acts or regulations governing the use of covered bonds and it does not appear they are in use in the Maldives today. [HDFC is refinancing its mortgages using a similar technique but on a contract by contract basis.]

Within this general category there are many possible variations. And as with secured bonds I do not think the CMDA wants to define rigidly what the structure *must* be. But we are faced with the same "truth in advertising" concern here and need to set the minimum requirements for labeling.

I am attaching suggested language as an Appendix and believe it would be optimal to include it in the same location as the language on secured bonds. The main points are:

- The bonds are created using the same process as for secured bonds.
- The allowable cover assets are mortgages on real estate, financial leases, investment securities, GoM securities, and securities issued by the MMA.
- The cover assets must be denominated in the same currency as the covered bonds, have a remaining term (maturity) equal or longer than the

remaining maturity of the covered bonds, and collectively generate an income stream that is sufficient to pay the stated interest on the bonds.

- Mortgages or financial leases used as cover assets may have an assessed value no greater than 80% of the estimated market value of the underlying property.
- The value of the cover assets must be at all times at least 120% of the outstanding principal amount of the covered bonds.
- Each class of covered bonds created by an issuer shall be secured with a separate cover pool.
- Pledges of assets shall be recorded and perfected in the same manner as for secured bonds.
- Unless a shorter period is established by the bond indenture or offering prospectus, the bondholders' representative shall verify at least semi-annually the compliance of the cover pool with the legal requirements.

SUMMARY OF ACTIONS TO ENCOURAGE USE OF COVERED BONDS	
Needed Action	Location of Adjustment
Establish minimum requirements for describing an instrument as a "covered bond"	New Text set out in Appendices

COLLECTIVE INVESTMENT SCHEMES

Scope of Collective Investment Scheme Regulation. The next three products relate to variations on the theme of collective investment schemes ("CIS"), an area of securities regulation that raises numerous policy issues and regulatory challenges. The threshold question is how "CIS" should be defined.

The draft CIS bill is modeled on the UK law.²¹ It certainly is a credible model. But my concern is that its coverage is too broad. A CIS is defined as "any arrangement with respect to property of any description ...".

This reflects the "consumer protection" approach to securities regulation that is the underlying philosophy of the EU, UK and the US. Under this approach the regulatory reach is broad and the possible private sector variations on a product numerous.

My concern is that such an aggressive scope – although completely appropriate for the developed markets – is simply too much for the Maldives to tackle in one step. Defining CIS in this manner would create a huge – and in all honesty unmeetable -- regulatory obligation for the CMDA, given its current resources. Moreover, it would open the door to products which in fact do not have much application for the Maldives yet could be licensed here by unscrupulous operators.

What we need is "CIS lite" with understandable products, a workable regulatory framework, and achievable supervision. In pursuit of this goal I am suggesting three

²¹ Please see the Explanatory Note on the CIS Bill by Osborne Clark dated June 6, 2008.

chapters to be included in one Investment Funds Act.²² I am defining Investment Funds as (1) securitizations, (2) investment funds, and (3) real estate funds. Each of these will in turn have its own definition. There will be two main drivers for compliance with the Act. First, there will be prohibitive and mandatory requirements, with penalties for violation. Second, there will be requirements that must be met in order for the fund to achieve tax transparency. This is more along the lines of inducement for compliance.

Tax Treatment. In the normal course of introducing investment funds into a jurisdiction the securities commission would draft a new Act on investment funds and then seek amendments to the corporate tax code to enable “tax transparency”. Thus, there are two sets of laws that must be introduced to a Parliament. Both are major pieces of legislation.

It appears the Maldives does not have to follow this path. There is a quicker, easier method available: (1) the Maldives can enable the MIRA to issue regulations providing tax transparency for investment funds rather than amend the BPT later, and (2) the CMDA can take advantage of its authority under SA Article 60(a) to adopt a comprehensive regulation on investment funds to cover classic investment funds, real estate funds and securitizations.

I suggest revising BPT Article 15 by adding a subclause (d):

(d) The MIRA shall have the authority to issue regulations governing the taxation of investment funds regulated by the Capital Markets Development Authority, including exemption from taxation under this Act and other Acts related to taxation, under specified conditions.

(suggested added language underlined)

This should provide the MIRA with the authority and latitude it needs to develop a tax transparency policy in coordination with the CMDA.

Limited Partnership Form for Investment Funds. One of the driving considerations for liberalizing the use of LLPs is to allow them to be used as the legal form for IFs. Because the Maldives does not possess the Trust or Contractual Plan legal concepts, it becomes even more imperative to ‘open up’ the use of the LLP. I will not repeat here all of the proposed revisions to the Partnership Act but instead only emphasize that without these changes it is difficult to imagine how some types of IFs will arise in the Maldives.

Classifying Investment Fund Shares (Units) as “Securities”. It will be necessary to include investment funds shares (units) as securities. Rather than amend the Securities Act, it may be preferable to amend the definition of security in the Regulation of Issuances and Regulation on Continuing Disclosure Obligations. This will include the offer and sale of investment fund shares in the prospectus requirements and require investment funds to issue periodic disclosure. Language has been included at Article 2 for both Regulations.

²² To avoid giving the impression that the Maldives is adopting the broad CIS concept I have titled the overarching Act as the Investment Funds Act. This is not a perfect description because the middle category -- classic securities investment funds -- carry the same description. But this Act does not have the scope of the UK CIS Act and describing it as such may be misleading.

General Points for All Investment Funds. The following are the key points under the IF Act covering all types of investment funds:

1. The permissible forms of investment fund can be Plc or LLP.
2. Shares or units in investment funds shall be in dematerialized form.
3. Share or units in closed-end investment funds shall be registered at the MSD, which shall act as the registrar.
4. Funds shall report using IFRS, with audits of financial statements conducted according to International Standards on Auditing.

Securitizations. The following are the key points under the new Chapter of the IF Act covering Securitization:

1. Securitizations can be formed only as closed-end funds.
2. The securitization pool can consist of any security or financial instrument, but not title to real estate or physical movable assets.
3. The diversification requirements do not apply.
4. The assets within the pool may be domestic or foreign assets.
5. An administrator must be appointed to service the pool payments.
6. The administrator may not be affiliated with the packager or its management.
7. The packager may be an originator or servicer of the assets within the pool.
8. The pool portfolio shall be fixed.

Investment Funds. The following are the key points under the new Chapter of the IF Act covering Investment Funds:

1. The investment fund portfolio can consist of any security or financial instrument, but not title to real estate or physical movable assets.
2. Open-end funds are only allowed for money market funds.
3. Interval funds and closed-end funds are allowed for all types of portfolios.
4. The diversification limits apply.
5. The Fund Manager may not be affiliated with any of the issuers (or management of such issuers) of the securities held by the fund.
6. For open-end funds, the Fund Manager may also act as registrar.
7. Fund assets shall be held by a custodian.

Real Estate Funds. The following are the key points under the new Chapter of the IF Act covering Real Estate Funds:

1. Open-end real estate funds are prohibited.
2. Interval and closed-end real estate funds are allowed.
3. Fund Managers of real estate funds may not be affiliated with any of the real estate (or operators of such real estate).
4. The diversification requirements apply.
5. Real estate funds are not allowed to incur debt as part of their operations.
6. Funds are required to use qualified, independent appraisers to provide estimates for the real estate interests held.
7. Fund assets shall be held by a custodian.

SUMMARY OF ACTIONS TO ENCOURAGE USE OF INVESTMENT FUNDS	
Needed Action	Location of Adjustment
Introduce Chapter on Securitization within new Collective Investment Schemes Act	New Text set out in Appendices
Introduce Chapter on Securities Investment Funds within new Collective Investment Schemes Act	New Text set out in Appendices
Introduce Chapter on Real Estate Funds within new Collective Investment Schemes Act	New Text set out in Appendices
Revise the definition of “security” to include shares and units issued by investment funds.	Regulation on Issuances Art 2 Regulation on Disclosure Art 2
Obtain authority for the MIRA to adopt regulation governing taxation of investment funds	BPT Article 15(d)

Legal Entities

This second part of the Section organizes the comments by type of legal entity.

PVT LTD’S

The proposed changes in the Acts and Regulations concerning Pvt Ltd’s relate to the ability of the entity to issue categories of securities and how the terms and conditions will be honored. The mechanics of how Pvt Ltd’s operate have not been revised, except to the extent that it impacts the attractiveness of the securities.

The cumulative impact of the suggested amendments, as they related to Pvt Ltd’s is as follows:

1. Under the proposed adjustments to CA Article 23, Pvt Ltd’s are allowed to issue (1) preferred shares (that are not convertible into common shares or carry continent of actual voting rights), and (2) corporate bonds (debentures).²³
2. The transfer of unpaid or partly paid securities is prohibited.
3. The limitation on the number of owners of “shares” has been made clear to relate only to “common shares”.
4. In order to convert from Plc to Pvt Ltd status the company must certify is has 50 or less owners of its common shares.
5. Language relating to the priority of securities issued by the company has been included in the CA General Regulation.
6. Language relating to foreign currency denomination of preferred shares and debentures has been added to the CA General Regulation.

²³ The essence of the Pvt Ltd is that it is a corporate entity owned by a small and tightly controlled group of persons. The number of voting shareholders is limited to 50. This does not, however, mean that the company must be small in financial size or that it cannot tap the capital markets. Allowing Pvt Ltd’s to issue nonvoting securities (preferred shares and corporate debt) is completely consistent with the Pvt Ltd concept

7. Limitations on the size of offerings in CA Article 25 have been relaxed.
8. The ability of issuing preferred shares and debentures with added features has been confirmed.
9. A requirement to pay all dividends and interest on senior securities before paying dividends on common shares has been added.

PLC's

Again, the proposed changes in the Acts and Regulations concerning Plc's relate to the ability of the entity to issue categories of securities and how the terms and conditions will be honored. The mechanics of how a Plc operates have not been revised, except to the extent that it impacts the attractiveness of the securities.

The cumulative impact of the suggested amendments, as they related to Plc's is as follows:

1. Under the adjustments to CA Article 23, unpaid and partly paid securities shall not be transferable.
2. Upon conversion to Plc status, the Pvt Ltd is not required to file a prospectus. This is required only if the Plc wishes to conduct a public offering. If no public offering is contemplated then audited financial statements for its latest fiscal year are required.
3. Language relating to the priority of securities issued by the company has been included in the CA General Regulation.
4. Language relating to foreign currency denomination of preferred shares and debentures has been added to the CA General Regulation.
5. Limitations on the size of offerings in CA Article 25 have been relaxed.
6. The requirement to file a prospectus in order to commence business as a Plc (CA Article 43) has been eliminated.
7. The ability of issuing preferred shares and debentures with added features has been confirmed.
8. A requirement to pay all dividends and interest on senior securities before paying dividends on common shares has been added.

LIMITED PARTNERSHIPS

In contrast to the Pvt Ltd's and Plc's, I believe significant adjustments should be made to the Partnership Act to make LLPs a viable legal entity for use in the capital markets.²⁴ As the Act now stands LLPs cannot be used as a legal form for investment funds, a fact made very significant given that the legal forms of Trust and Contractual Plans do not exist in the Maldives.

In addition, there is no reason why the LLP form should not be used as an alternative to the corporate form for running large businesses. Thus, I have included several suggested changes to the Partnership Act to make LLPs a more attractive business form and a potential issuer of securities.

²⁴ On September 21st, I provided comments to the draft General Regulation on Partnerships.

Limitation on Number of Partners. The Partnership Act seems to equate “limited liability” with “limited participation”. I do not think this is correct and in fact is contrary to the use of limited partnerships in the global markets.

For this reason I suggest that PA Section 6 be revised to read:

~~6. The number of partners in a partnership shall not be more than 20~~
Unless specified to the contrary in the partnership agreement, the number of possible partners in a partnership shall not be limited.

Liability of the Limited Partners. The major premise underlying a LLP is that the limited partners’ liability is limited to their fully paid-in capital. The managing partner has sole control over running the business and unlimited liability for its debts.

Yet there is some confusion – and even conflict – between several relevant provisions of the Maldivian law. Current PA Article 23(3) could be read to set the liability of a limited partner to partially paid shares. This is not correct. The liability is for the fully-paid amount. I suggest revising Article 23(3) as follows:

~~(3) In a limited liability partnership, the partners shall be responsible for the liabilities of the partnership to the extent of any payment outstanding to the partnership for the shares taken or agreed to be taken, or to the extent agreed to be responsible for the liabilities of the partnership.~~

(3) In a limited liability partnership, a limited partner shall be responsible for the liabilities of the partnership to the extent of (a) his/her/its paid-in capital for the shares, plus any unpaid amount due under the subscription agreement for the shares, or (b) a greater amount to the extent as agreed within the partnership agreement.

Tax Liability of Limited Partners. Section 30(4) of the Partnership Act states:

In a limited liability partnership, the partners shall not have personal responsibility for the debts and other obligations of the partnership.

This limited liability is reinforced by PA Section 23(3) cited just above. However, the Business Profits Tax Act at Section 5 states:

5. [(1)-(2) omitted]

(3) A partner in such a partnership shall not be charged to tax in respect of his share of the profits nor shall any loss accruing to him from the partnership be brought into account in computing the tax liability of the partner;

(4) Every Person who is a partner in that year shall be jointly and severally liable to pay any tax due and payable under this Act in respect of those profits.

To me, the BPT conflicts with the Partnership Act. The treatment under PA Section 30(4) is the correct approach.

I suggest deleting BPT Section 5(4) and add the following three subsections:

(4) Every partner in a general partnership who is a partner in that year shall be jointly and severally liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were partners.

(5) Any managing partner of a limited liability partnership shall be liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were managing partners.

(6) Limited partners of a limited liability partnership shall not be liable for the tax obligation of the partnership, except to the extent that payment of the liability results in the dissolution of the partnership and then only to the extent of liability specified in the Partnership Act.

Managing Partners in a Limited Partnership. A legal entity should be allowed to be a Managing Partner of a limited liability partnership. This is standard practice in more developed markets. It is unrealistic to expect a natural person to volunteer to be a managing partner of a large partnership due to the unlimited personal liability. Thus in order to facilitate a widely-held LLP, a legal entity should be allowed to be managing partner.

Section 10(1) should be revised as follows:

(1) Every partnership shall have a managing partner. For limited liability partnerships, the managing partner may be a natural person or legal entity.

Section 10(3) should be revised as follows to conform:

(3) Managing partner shall be ~~a natural person~~ resident in Maldives.

Authorized Agents. For a LLP, the managing partner should be the only person (entity) allowed to bind the partnership. If the managing partner is the only partner with unlimited liability it does not make sense to allow the limited partners to act as agents to incur obligations for which they are not liable. For this reason the managing partner should be the only authorized agent.

Partnership Act Section 24(2) should be revised as follows:

(2) ~~Every partner~~ The Managing Partner of a limited liability partnership, for the purpose of the business of that partnership, shall be considered as ~~an~~ the sole agent of the partnership as a whole, and any transaction done by a partner in the ordinary course of business shall be binding on the partnership as a whole.

Liability of the Managing Partner. To conform the division of liability between managing and limited partners I suggest adding subsection (e) to PA Article 11:

11. Managing Partner shall –

[points a-d omitted]

(e) with regard to a limited liability partnership, be liable for debts and other obligations of the partnership.

Ability to Issue Debentures. As mentioned above in the corporate debt section I am suggesting that LLPs be allowed to issue debentures. This will help adapt the LLP concept to practices used in more developed markets. I have added language to the Partnership Act after Articles 11 and 40. I have also included as an Appendix suggested implementing language for the Partnership General Regulation.

Classifying Limited Partnership Interests as “Securities”. In order to enable LLPs to be used as a form for investment funds, an LLP interest must be included in the definition of “securities”. This will also allow large LLPs to be considered as “reporting companies” and to have their units listed or admitted to the MSE. In short, LLP units

must be included in the definition of securities in order to allow LLPs to be used for large operations with public ownership.

This could be achieved by amending the SA Article 62. Instead, however, I suggest the CMDA use its power under point 3 of the definition and include this in the Regulation on Continuing Disclosure Obligations and Regulation on Issuances.

SUMMARY OF ACTIONS TO ENCOURAGE USE OF LIMITED LIABILITY PARTNERSHIPS	
Needed Action	Location of Adjustment
Remove the limitation on the number of partners	PA Article 6
Make clear that the limited partners liability is for the amount of fully-paid units	PA Article 23(3)
Amend the Business Profits Tax Act to conform to the limited liability set out in PA Article 23(3) and 30(4).	BPT Article 5
Allow legal entities to be managing partners of a LLP	PA Article 10
Allow only the managing partner of a LLP to bind the partnership	PA Article 24(2)
Make clear that the managing partner is liable for the LLPs obligations	PA Article 11(e)
Allow LLPs to issue debentures	PA Article 11+ Partnership Gen Reg
Include LLP interests within the definition of "securities"	Reg on Issuance Article 2 Reg on Disclosure Article 2

TRUSTS

The scope of work for this legal and regulatory assessment specifically includes a review of the Trusts Bill. Having reviewed the draft, and with the benefit of the on-site information, I am not sure that this should be a priority for the CMDA.

Trusts are a legal form; they are not a type of security. For example, a company wishing to raise capital does not issue a "trust", it issues an equity or debt security. A Trust is a way of organizing a business and is an alternative legal form just as a company or a partnership is.

The benefit of having the concept of a Trust embedded in a legal regime is that it comes as a package of ideas and practices. The problem for the Maldives is that this package is – in most all developed markets where it is used – the product of almost centuries of legal precedent. Indeed, the Trust concept is mostly an Anglo-Saxon vehicle underpinned by common law precedent. It requires extensive, specific language to be adopted in "code" jurisdictions.

Thus, in order for the concept to be adopted in the Maldives, the Trust Act would not only need to contain all of the basics of organization and operation, it would also need to record many aspects of trust law that are understood from the related history of court rulings. This is an immense body of law and capturing it succinctly would be a challenge. Indeed, the current Trust Bill (at 44 pages in length) is fairly impressive in that it does achieve so much in so relatively small space.

For these reasons I think it will be difficult to get a Trust Bill passed by the Majlis. The guidance has been specific and direct: simple Acts workable for a relatively simple economy are strongly preferred. The current Bill, drafted using the highly evolved Isle of Jersey model, does not fit the preferred description.

Apart from the drafting challenges I am not sure the Maldives urgently needs a Trust Act. The only real application for the 8 categories of investment securities under consideration would be for investment funds and real estate funds. But in the Maldivian context I believe that adjusting the current LLP framework to serve as a vehicle for investment funds is a more promising approach than creating the Trust concept *ab initio*.

Further, I do not believe that investment funds and real estate funds are high probability prospects for the Maldivian market. The reasons are different for the two categories but the conclusion the same.

In sum, I believe the CMDA's and GoM's need to enable the more promising categories of securities should take precedence. Focusing on adopting the Trust concept here will require a lot of resources with only incremental benefit.

Regulatory Architecture

It is difficult to gauge why more companies have not sold securities, either privately or publicly. During the on-site I met with some potential issuers but they possessed unique reasons for not yet coming to market. During the next on-site perhaps more meetings with potential issuers would help fill out this picture.

There are several generic reasons, encountered in many emerging markets, why private companies do not wish to sell securities publicly.

The first is a fear of loss of control. There is simply no way to get around this concern when speaking of selling common shares. But the ability to sell preferred shares and debentures provide choices for financing that do not implicate a change of controlling ownership. This is one reason why I have focused strongly on the preferred shares and debenture categories.

The second is a conflict between the management style of the one-person private company and the way a public company should be managed. Some companies have grown big under a style that simply does not lend itself to going public.

The third is a fear of transparency. And in this regard I think the Maldives could make some adjustments on the source of the ongoing disclosure requirements. This might encourage more companies to issue securities. But I want to emphasize that the trade-off for being allowed to tap the capital markets is a commitment and requirement to issue period reports to the general public. This shall not change under the below recommendations. But we may achieve more companies issuing securities and more organized trading.

DELINKING THE DISCLOSURE OBLIGATION FROM THE LISTING DECISION

When we read the Company Act and Securities Act taken together we can see that there are three separate decisions for a company that are bundled into one. This creates a lack of flexibility within the system and makes participation by a potential issuer quantum. Either the company is "all-in" or not. And there is no reason why it should be this way. Investors can still be protected while giving potential issuers more choice on how far they wish to enter the market.

The decisions that are bundled are:

1. Conversion from Pvt Ltd to Plc status. Please see CA Article 20(a) and (b).
2. “Filing of a prospectus”, which implies conducting a public offering. Please see CA Article 20(b)(4); and
3. Listing the securities on the Maldives Stock Exchange. Please see CA General Regulation Article 16.

Under the current structure, either a company does all three or none. But, this regulatory approach ignores an issuer’s possible goals:

Conversion from Pvt Ltd to Plc: The company may wish to convert simply to allow existing shareholders to sell their shares privately without restriction.

Offering of securities: The company may wish only to make a private placement to a few new investors.

Listing: The company may not wish to pay the listing fee or care how its securities are traded.

And most importantly, *because conducting a public offering requires the company to list and therefore incur the continuing disclosure obligations, there is a disincentive to list.*

Further, *because the listing rules allow a company to delist only with the permission of the MSE, companies entering listing become “corporate prisoners”.* Clearly this is an additional disincentive to list.

In my view, we should unbundle the process. We should allow companies to convert from Pvt Ltd to Plc and stop there. We should not require a further offering. We should allow both public offerings and private placements after conversion. We should not require listing upon conducting a public offering.

But, in this latter case, the question becomes: if companies are not required to list after a public offering how do we achieve continuing disclosure to protect investors? A summary of the problem is as follows:

1. We want to give Maldivian companies flexibility on their structure and offerings.
2. The current process is bundled, inhibiting the movement from Pvt Ltd to Plc.
3. There is a disincentive to list because it requires periodic disclosure.
4. We need an answer that solves these obstacles but still preserves investor protection.

To me, the solution lies in delinking the listing decision from the obligation to file continuing disclosure. We do this by creating the concept of a “Reporting Company” and then require all Reporting Companies to file continuing disclosure. We place this requirement in the securities Act or regulations, not the listing rules. Thus, Reporting Companies that are not listed still have to file the reports.

Further we should include companies above a certain size as Reporting Companies. The reason for this is that owners with only a small percentage ownership have little power to obtain the transparency they need. Under the definition it does not matter how the company has attained the size – whether through a series of private placements or a public offering. What matters is that the company is held by a large

number of shareholders who cannot, by themselves individually, compel transparency. Without the intervention of securities regulation the investors will be left unprotected.

So I would suggest a definition of “Reporting Company” as any legal entity that:

1. Has [#] or more owners of any outstanding class of its securities, and [#] of more in net assets [*underlined language optional*];
2. Has a class of its securities listed on any exchange; **or**
3. Has conducted a public offering of securities within the last [#] of its fiscal years.

Under this definition a company becomes a reporting company by:

CONDITIONS FOR BECOMING A REPORTING COMPANY	
Size	Not Voluntary
Listing	Voluntary Company Decision
Conducting a “Public Offering”	Voluntary Company Decision

This delinks the listing decision from the reporting obligation yet preserves the transparency goals.

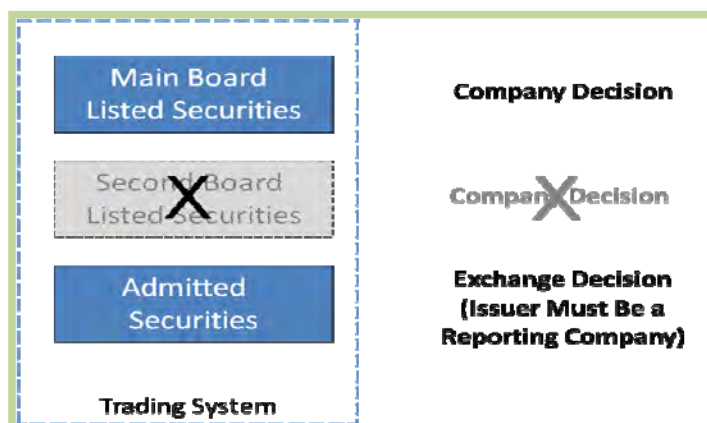
ADOPTING THE ADMITTED FOR TRADING CONCEPT

However, under this approach there still remains the question of how we promote organized trading in the company’s securities. I believe the answer lies in creating the concept of securities “admitted for trading”. Under this approach:

1. The MSE can “admit” securities issued by Reporting Companies for trading on its system;
2. Upon admission of the security, all exchange members must conduct trading in that security through the exchange system; and
3. The decision rests with the exchange, not the company.²⁵

As a result of the above the configuration of the MSE would change. The 2nd Tier which is currently unused would be converted to the “Admitted Tier”.

²⁵ An important proviso to this approach is that there should be no additional regulatory burden or costs resulting to the company due to the exchange’s decision. This would be basically unfair. It also may raise Constitutional questions.



To achieve all of the above I believe that we should:

1. Delete the prospectus filing requirement upon conversion from Pvt Ltd to Plc. Please see CA Article 20;
2. Delete the listing requirement upon public offering. Please see CA General Regulation Article 16;
3. Create the concept of Reporting Company within the Regulation on Continuing Disclosure Obligations.
4. Revise the Regulation to apply to Reporting Companies, not “listed companies”.
5. In order to complete the effectiveness of the definition of Reporting Company, adopt a definition of “Public Offering” and place this in the Regulation on Issuances.
6. Create the category for Private Placements and place this in the Regulation on Issuances.
7. Revise the MSE Listing Rules to:
 - a) Delete the specificity of the reporting requirements, referring only to the Securities Act and Regulations
 - b) Convert the 2nd Tier to the “Admitted for Trading” concept.

DEFINING PUBLIC OFFER AND PRIVATE PLACEMENT

In the Maldives, the Company Act contains many provisions one would expect to find in the Securities Act. It has, for example, an entire section on offerings and a prospectus requirement. This can be explained by the fact that the Company Act preceded the Securities Act by some years.

This overlap creates some problems as we try to better define the offer and sale process. CA Article 24 specifically requires a prospectus for sales “to the public” and further states that needed details will be supplied under the CA General Regulation. Moreover, the Securities Act states that the prospectus is filed with the Registrar of Companies. The CMDA is trying to normalize the regulation of offerings and has a draft Regulation on Issuances. But it does not appear that defining public offerings and detailing the prospectus details and process can be done outside the context of the CA or the General Regulation.

My suggestion is to place a definition of “public offering” and “private placement” in the CA General Regulation in the Interpretations section. A parallel set of language can

be placed at Section 2 and 3 of the draft Regulation on Issuances. Essentially the concept is that:

1. A prospectus shall be required for all “public offerings” of securities.
2. Offers and sales of securities qualifying as “private placements” shall be exempt from the prospectus requirement (subject to some rules preventing using a series of private placements as a substitute for a public offering).
3. “Public offering” will be defined to include any offer or sale of securities: (i) to more than 50 persons; (ii) to an undetermined number of investors; (iii) made by use of general advertisement, the media and/or publication via the internet; or (iv) resulting in more than 50 purchasers from the issuer, or any affiliates.
4. “Private placement” will be defined to include “small” offerings, e.g., those (i) expressly confined to 50 persons or less; (ii) made to qualified investors only; or (iii) where the total offering is for 750,000 MRf or less.

V. SUMMARY OF ACTIONS REQUIRED

	Company Act	Company General Regulation	Partnership Act	Regulation on Continuing Disclosure	Regulation on Issuance	Business Profits Tax Act
BY PRODUCT						
Preferred Shares						
Allow Pvt Ltd's to issue preferred shares	Article 23(a)-(c)	Article 5+				
Set minimum investor protection for preferred shares issued by Pvt Ltd's and Plc's.		Article 5+				
Allow foreign currency denomination of preferred shares		Article 5+				
Eliminate the securities offering size limit OR revise the calculation OR impose a debt-to-equity ratio limit	Article 25					
Establish priority of preferred shares in wind-ups and priority of dividends	Article 91	Article 9+				
Allow payment-in-kind dividends, rights to participate in profits, put rights, call rights and convertibility.		Article 5+				
Corporate Debt						
Allow Pvt Ltd's to issue debentures	Article 23(a)-(c)	Article 5+				
Allow LLPs to issue debentures			Article 11+ Gen Reg			
Allow foreign currency denomination of debentures		Article 5+				

	Company Act	Company General Regulation	Partnership Act	Regulation on Continuing Disclosure	Regulation on Issuance	Business Profits Tax Act
Establish priority of debentures in a wind-up situations and priority for interest	Article 91	Article 9+	Article 11+ and 40+			
Interest paid on corporate debt to be tax deductible						Article 11(5)
Establish minimum requirements for "corporate bonds" "secured bonds" or "guaranteed bonds"		New Text			New Text	
Allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility		Article 5+				
Covered Bonds						
Introduce all aspects of covered bonds		New Text	New Text for General Regulation	New Text	New Text	
Investment Funds						
Introduce new IF Act with chapters on securitization, investment funds and real estate funds						
Obtain authority for the MIRA to set tax policy for investment funds.						Article 15(d)
Include IF shares and units within the definition of security.				Article 2	Article 2	
BY LEGAL ENTITY FORM						
Pvt Ltd's						
Allow Pvt Ltd's to issue preferred shares and debentures	Article 23(a)-(c)	Article 5+				

	Company Act	Company General Regulation	Partnership Act	Regulation on Continuing Disclosure	Regulation on Issuance	Business Profits Tax Act
Set minimum investor protection for preferred shares issued by Pvt Ltd's		Article 5+				
Allow foreign currency denomination of preferred shares and debentures		Article 5+				
Eliminate the securities offering size limit OR revise the calculation OR impose a debt-to-equity ratio limit	Article 25					
Establish priority of preferred shares and debentures in a wind-up situation and of dividends / interest	Article 91	Article 9+				
Interest paid on corporate debt to be tax deductible						Article 11(5)
Establish minimum requirements for describing an instrument as a "corporate bond" "secured" or "guaranteed bonds"		New Text			New Text	
<i>For Preferred Shares:</i> allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility		Article 5+				
<i>For Debentures:</i> allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility		Article 5+				
Plc's						
Set minimum investor protection for preferred shares issued by Plc's.		Article 5+				
Allow foreign currency denomination of preferred shares and debentures		Article 5+				
Eliminate the securities offering size limit OR revise the calculation OR impose a debt-to-equity ratio limit	Article 25					

	Company Act	Company General Regulation	Partnership Act	Regulation on Continuing Disclosure	Regulation on Issuance	Business Profits Tax Act
Establish the priority of preferred shares and debentures in a wind-up situation and priority of dividends / interest	Article 91	Article 9+				
Interest paid on corporate debt to be tax deductible						Article 11(5)
Establish minimum requirements for describing an instrument as a “corporate bond” and for describing it as “secured” or “guaranteed”		New Text			New Text	
<i>For Preferred Shares:</i> Specifically allow payment-in-kind dividends, rights to participate in profits, put rights, call rights and convertibility.		Article 5+				
<i>For Debentures:</i> allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility		Article 5+				
LLPs						
Allow LLPs to issue debentures			Article 11+ Partnership Gen Reg			
Allow LLPs as form on investment fund				Article 2	Article 2	
Allow foreign currency denomination of debentures			Article 11+ Partnership Gen Reg			
Establish the priority of debentures in a wind-up situation and for interest			Article 11+ and 40+			
Interest paid on corporate debt to be tax deductible						Article 11(5)

	Company Act	Company General Regulation	Partnership Act	Regulation on Continuing Disclosure	Regulation on Issuance	Business Profits Tax Act
Establish minimum requirements for describing an instrument as a “corporate bond” and for describing it as “secured” or “guaranteed bond”			New Text		New Text	
<i>For Debentures:</i> allow payment-in-kind interest, variable rate interest, put rights, call rights and convertibility			New Text to PA Gen Reg to track CA Gen Reg Article 5+			
TO ADOPT ADMITTED FOR TRADING						
Delete the prospectus filing requirement upon conversion from Pvt Ltd to Plc.	Article 20					
Delete the listing requirement upon public offering.		CA General Regulation Article 16				
Create the concept of Reporting Company.				New Text		
Revise the Regulation to apply to Reporting Companies, not “listed companies”.				New Text		
adopt a definition of “Public Offering”					New Text	
Create the category for Private Placements					New Text	

VI. NEAR-TERM INFRASTRUCTURE ISSUES

During the review a number of issues arose which relate to the capital market infrastructure, the regulatory structure and record-keeping. Strictly speaking these do not relate directly to the increased issuance of existing securities and the creation of new types. However, if these “organization” issues are addressed they should lead to decreased operational cost in the system, decreased regulatory costs for issuers and participants and reduced opportunities for misconduct within the securities markets. I outline these issues below but have not included suggested amendments to Acts and regulations to implement them.

Physical Certificates. Most emerging markets have moved (are moving) towards dematerialized securities and electronic record-keeping. This significantly reduces costs for the system in that physical pieces of paper do not need to be processed. It also almost eliminates the chances of forgery. I recognize that there may be a preference in any culture for the physical certificates but with generational change this is lessening. My recommendation would be to move towards dematerialized securities. This would require adjustment to CA Article 34.

Handling of Securities Ownership Records. Closely related to the above is the Maldives’ current practice of allowing each company issuer to maintain its securities registry. Most emerging markets have moved (are moving) towards the use of a central registry. This is aided by the adoption of dematerialized securities. Having an independent central registry reduces the possibility of company misconduct. It also assists in the clearance and settlement process. My recommendation would be to require all Plc’s to turn over their securities registries to the MSD and to have the MSD act as the central securities registry. This would require adjustments to CA Article 37.

One Share / One Vote. Company Act Articles 58 and 62 do not follow the concept of one share / one vote. Instead it is a mishmash of votes per person present and votes according to percentages held. If the Majlis is going to take up amendments to the CA I would urge a review and rewrite of the voting rights and quorum provisions.

Corporate Reporting. It appears that companies in the Maldives are filing financial statements with up to three separate government entities. Companies file with the MIRA. The goal is clear: to assess and collect taxes due. Some companies file with the CMDA. The goal is also clear: to protect public investors by requiring companies to provide full, accurate disclosure of their operating results.

The Registrar of Companies also requires financial reports from *all registered companies*. But for what goal? In my experience most countries do not require filings of financial statements with the registrar. At most they require summary financial data such as revenues, net income, assets, liabilities and shareholders’ equity.

The Maldives could greatly streamline the corporate reporting process, which should eliminate unnecessary compliance costs for many companies, and achieve economies of scale for the government.

1. The requirement that Pvt Ltd companies file financial statements with the Registrar could be eliminated. The rules should require only annual statements of management and owners. Changes in location and the designated person for receipt of official communications should be made promptly.

2. Plc's could be required only to file summary financial information such as revenues, gross income, net income, total assets, total liabilities, and paid in capital.
3. Companies could file with the Registrar annually using the same filing deadlines as the MIRA (synchronize the filing dates).
4. The same financial statements used for filing with the MIRA could be used to support the data required by the Registrar. This would mean using the same financial reporting standards as used for the MIRA filings and using the same auditor's statement.
5. The location of the Registrar within the government could be transferred to the CMDA. This will allow integrated enforcement of the Companies Act and Securities Act. It would also allow one integrated IT system. In this configuration the Registrar would remain as a separate entity but reporting to (and integrated with) CMDA systems.

VII. DRAFT AMENDMENTS AND NEW DOCUMENTS

Suggested Amendments to Acts and Regulations, and suggested new language are attached as Appendices.

MARKED TEXT COMPANY ACT

For purposes of this Report, the sections of the current Act that have not been revised are omitted from this version.

An unofficial translation

**THE COMPANIES ACT OF THE REPUBLIC OF MALDIVES LAW
NO: 10/96**

* * * *

Private Companies and Public Companies

3. a) Any two (2) or more persons may as prescribed in this Act, having the liability of its members limited, form a private company. A private company is a company whose memorandum and articles of association states that it is a private company, and that common shares may only be transferred in accordance with its articles of association and the number of members of the company is limited to fifty (50) and the sale of common shares to the public is prohibited by the articles of association.
- b) Any ~~two or~~ (240) or more persons may in accordance with this Act having the liability of its members limited, form a public company. A public company is a company whose memorandum and articles of association states that it is a public company and can sell securities shares to the public in accordance with this Act.

* * * *

Contents of the articles

6. a) The articles of association of every company must prescribe, in accordance with this Act, how the company shall be managed.
- b) The articles of association of every private company must state that:
1. It cannot sell common shares to the public.
 2. Common Shares of the company may only be transferred to a party approved by the Board of Directors in accordance with the articles.
 3. The number of owners of common shares shareholders of the company is limited to fifty.

Registration

7. a) The persons forming a company shall submit to the Registrar of Companies the memorandum and articles of association together with the registration fee and the annual fee specified in the schedules of this Act.
- The company shall be registered if the contents of the memorandum and articles of association do not contravene the Islamic principles or this Act or any other laws of the Country.
- b) Every company registered under this Act shall pay the annual fee specified in the schedule of this Act. If a company fails to pay the annual fee as

Comment [R1]: Insertion of the references to "common" shares makes clear that the restrictions do not apply to the issuance and transfer of preferred shares.

Appendix A: Company Act Amendments

stipulated in the schedule by the end of March, the Registrar of Companies reserves the right to suspend all business activities of the company until payment of the fee. If the annual fee remains unpaid by the end of May, the Registrar shall apply to the court for the winding up of the company.

Registration of private companies

c) A private company shall be registered if the company's memorandum and articles of association states that it is a private company and if the authorized capital of the company stipulated in the memorandum and articles of the company is not less than MRF 2,000/- and the articles of association states that the company's common shares may only be transferred from a member to another person in accordance with the articles of association and the memorandum and articles of association limits the number of owners of common shares membership of the company to fifty and the articles of association prohibits the sales of common shares to the public.

* * * *

Private company becoming public

20. a) A private company may be re-registered as a public company by passing a special resolution that it should be so re-registered and an application for reregistration is delivered to the Registrar of Companies and the company is reregistered as a public company in accordance with this Act.
- b) The application for re-registration of a private company to a public company delivered to the Registrar of companies shall contain the following:
1. The special resolution passed by the private company to become public.
 2. The special resolution passed by the company to make such alterations in the memorandum and articles as are necessary to bring them into conformity with the requirement of this Act.
 3. The memorandum and articles of association of the company after bringing them into conformity with the memorandum and articles of association of a public company as prescribed in this Act.
 4. Audited annual financial statements for the company's latest fiscal year. ~~The company prospectus.~~
- c) If an application to re-register a private company to a public company is delivered to the Registrar of Companies in accordance with sub-section (a) and (b) of this section, the company shall be re-registered and the certificate of incorporation shall be issued if the requirements specified in this Act for the formation and registration of a public company are fulfilled.

Comment [R2]: This change is necessary to delink the conversion process from the offering process. It makes clear that an offering is not required upon conversion.

Public Company becoming private

21. a) A public company may be re-registered as a private company if a special resolution that it should be so re-registered is passed, and an application for reregistration is delivered to the Registrar of Companies and the company is reregistered as a private company in accordance with this act.
- b) The application for re-registration of a public company to a private company delivered to the Registrar of Companies shall contain the following:

Appendix A: Company Act Amendments

1. The special resolution passed by the public company to become private.
2. The special resolution passed by the company to make such alterations to the memorandum and the articles as are necessary to bring them in conformity with requirements of this Act.
3. The memorandum and the articles of association of the company after bringing them into conformity with the memorandum and the articles of association of a private company as prescribed in this Act.

4. A certification that the number of owners of the company's common shares is 50 or less.

c) If an application to re-register a public company as a private company is delivered to Registrar of Companies in accordance with sub-section (a) and (b) of this section, the company shall be re-registered and the certificate shall be issued if the requirements specified in this Act for the formation and registration of a private company are fulfilled.

* * * *

Offer of shares and debentures to the public

23. a) Companies ~~other than those~~ registered as Pvt Ltd under this Act ~~as public companies~~ shall not sell common shares or debentures to the in a public offering.

b) ~~The circumstances constituting Sale of shares and debentures to the a public offering shall be defined under the Securities Act and the Regulations promulgated under it. mean that the company's share and debentures may be purchased by any person of the public and that the shares and debentures of the company are freely transferable from one person to another without the approval of the company.~~

c) Companies registered as Pvt Ltd may offer and sell preferred shares and debentures under terms defined in the General Regulation.

d) The articles of association of any public company shall not prohibit the sale of shares and debentures to the public or the transfer of the same. However in instances where an unpaid or a partly paid securities shall not be transferrable. share is being transferred, the board of directors has the authority to object the transfer until full payment.

Prospectus

24. ~~Public C~~ompanies shall only offer and sell securities in a public offering shares and debentures to the public after issuing a prospectus in accordance with this Act and Regulations promulgated under this Act and as stipulated in the prospectus.

Permission to sell shares and debentures to the public and the amount

25. ~~Public companies shall sell shares and debentures to an amount equivalent to the amount paid up by its members for the time being for the shares and debentures of the company.~~

Within any consecutive 12 month period, companies shall be prohibited from selling securities in an amount greater than the outstanding value of their

Comment [R3]: This change is designed to ensure that a company cannot convert to Pvt Ltd if it has more than 50 holders of common shares, resulting in a violation of Articles 3 and 7(c).

Comment [R4]: This revision is designed to take the definition of the CA and place it within the fabric of the securities regulation where it properly belongs. The definition currently in 7(b) is not properly crafted. Please see proposed changes to the Regulation on Issuances.

Comment [R5]: This language is designed to make clear the Pvt Ltd's ability to issue securities other than common shares.

Comment [R6]: This corrects an error in approach.

Comment [R7]: Suggest delete this, or if retained redefine the limit as below

shareholders' equity plus total liabilities, calculated as of the beginning of the period.

A company shall be prohibited from selling debentures if the resulting sale would place the ratio of liabilities to shareholders' equity greater than a factor of [3].

Comment [R8]: If a debt to equity ratio limitation is desired, suggest this

* * * *

Securities Shares

Allotment of securities shares

29. If a company makes an allotment of its securities shares, it shall within thirty (30) days of such allotment deliver to the Registrar of Companies a list of names and addresses of the allottees, the number, the nature and the value of the securities shares allotted.

* * * *

Securities Shares jointly owned

32. Two or more persons may jointly own a security share, provided only one of them shall represent the share for the purpose of the company.

Comment [R9]: Given the addition of the right to issue preferred shares and debentures, it is now more appropriate to speak in some places of "securities" rather than "shares".

* * * *

Shares and debentures issued for a consideration

35. A company may issue shares and debentures to the public for any consideration subject to the Regulation promulgated under this Act, however no shares or debentures shall be issued at less than the nominal value.

Transfer of Securities Shares

36. The shares of any member in a company shall be movable property and is transferable in the case of private companies shares with the approval of the Board of Directors in accordance with the articles of association. Securities Share in a public company shall be recorded and transferred in accordance with this Act or as may be prescribed by the Regulations made under this Act or by the Authority.

Transfer of securities shares and registration

37. (a) If a share in a company is transferred from one person to another, the share transactions shall be registered in the company. A transfer shall deem to have taken place when a proper instrument of transfer is delivered to the company.

(b) the recording of ownership and transfer of debentures shall be prescribed by Regulation under this Act or by the Authority.

Comment [R10]: This is an attempt to move towards dematerialized securities for corporate debt. Please see suggest additional language for corporate bonds to be inserted into the CA General Regulation at Article or the Regulation on Issuances.

Transmission of securities shares

38. If a shareholder deceases, the company may in accordance with the articles of association register the securities shares held by the deceased member in the name of the person or persons whom the court declares as being entitled to hold the securities shares.

Failure to answer a call up for share payment

39. If a shareholder fails to pay for the ~~securities shares~~ he has subscribed after a call for payment has been made, the company may in accordance with its articles of association rescind the sale, return any consideration paid and cancel the subject securities~~forfeit the shares.~~

* * * *

Commencement of business

43. a) A private company may, upon its registration as stated in section 7 of this Act, commence its business as stated in the objectives of the company and as prescribed by regulations made under this Act.
- b) A public company shall commence business after registering the company as a public company under this Act, ~~and upon issuing a prospectus as stated in section 24 of this Act and after offering shares to the public to the amount stated in the prospectus and acceptance by the public to buy the shares and allotting the same as per the prospectus and upon receiving payment for the allotted shares and upon payment by the Directors of the company, the amount they have subscribed and having submitted evidence of payment by the Directors to the Registrar and when Registrar of Companies grants permission to commence the business only.~~

* * * *

Comment [R11]: This change is necessary to delink the creation of a Plc from the offering process. It makes clear that an offering is not required upon creating a Plc.

Quorum for a general meeting

58. Unless otherwise stipulated in the articles of all private or public companies, the majority of members of every private company shall constitute the quorum for a general meeting.
- The quorum of the general meeting of all public companies shall constitute five (5) members of the company holding not less than twenty percent (20%) of the voting shares of the company.

* * * *

Order of settling company's debt

91. The assets of the company in a winding up process under section 76 and 80 of this Act shall be applied, after deducting the expenses incurred for the winding up and the remuneration of the person or persons appointed to wind up the company, in the following order.
- a) Money due to the government or to government bodies.
- b) Wages due to the employees of the company except directors for three months from the date the court issued the winding up order or the company passed the special resolution to wind up the company.
- c) Monies due to secured creditors, to the extent of the value of the collateral pledged to them, with any remaining unpaid obligation considered to be unsecured.
- d) Monies due to unsecured creditors in pari passu.

Appendix A: Company Act Amendments

e) Nominal value of preferred shares plus any accrued but unpaid dividends, paid to their holders

f) Any remaining balance to be paid to holders of equity securities, according to the rights set out in the articles of association.

~~e) The balance, if any, after settling the payments stated in (a) and (b) if not sufficient to discharge all debts of the company shall be applied in satisfaction of the company's liabilities pari passu.~~

Comment [R12]: This section is designed to make the seniority of the classes of security clear.

MARKED TEXT COMPANY GENERAL REGULATION

For purposes of this Report, the sections of the current General Regulation that have not been revised are omitted from this version.

An unofficial translation

Companies General Regulation

These regulations are made in exercise of powers conferred to Ministry of Economic Development by section 101 of the Companies Act.

* * * *

5. Documents to have the name and registration number

The following materials shall have the name and the registration number of the company clearly stated on them

- i. Company documents, invoices, order forms and other similar materials
- ii. Documents and reports to be submitted to the Government
- iii. Negotiable instruments, letters of credit or similar documents where the company signature has to be attested.
- iv. Documents that have to be submitted to the registrar under the Act or regulations.

***. Categories of Permitted Preferred Shares**

(a) Companies registered as Pvt Ltd shall be permitted to issue preferred shares, provided that:

- i. the preferred shares do not carry the right to be converted into common shares of the company**
- ii. the preferred shares do not carry actual or contingent voting rights**
- iii. the preferred shares carry (a) the right to receive cumulative dividends and (b) the right to be converted into a class of debentures (defined prior to the creation and issuance of the preferred shares and established within the company's article of association), if the company fails to pay a required dividend for a period longer than 180 calendar days from the dividend due date.**

(b) Companies registered as Plc's shall be permitted to issue preferred shares, provided that:

- i. the preferred shares carry the right to be converted into (a) common shares of the company, or (b) a class of debentures (defined prior to the creation and issuance of the preferred shares and established within the company's article of association) OR**
- ii. contingent voting rights,**

Comment [R1]: This language implements my recommendation to clarify a company's ability to issue preferred shares.

if the company fails to pay a required dividend for a period longer than 180 calendar days from the dividend due date.

(c) A company may issue preferred shares denominated in a foreign currency only if the company is permitted under the laws of the Maldives to (i) compile and present its financial statements and (ii) submit its tax reports in that foreign currency.

(d) Subject to the limitations and requirements set forth in subsections (a) and (b) above, a company may issue preferred shares that:

- i. provide that dividends may be paid in the form of additional preferred shares of the same class, or another class of preferred shares;
- ii. provide that the preferred shares may further participate in dividends paid to common shares;
- iii. provide a right to the shareholder to sell the shares back to the company at a specified price and within a specified time;
- iv. provide a right to the company to buy the shares from the shareholder at a specified price and within a specified time; and
- v. provide a right to the shareholder to convert the preferred shares into another class of security issued by the company (defined prior to the creation and issuance of the preferred shares and established within the company's article of association).

***. Categories of Permitted Debentures**

(a) Companies registered as Pvt Ltd shall be permitted to issue debentures, provided that the debentures do not carry (a) the right to be converted into common shares of the company, or (b) actual or contingent voting rights

(b) Companies may issue debentures denominated in a foreign currency.

(c) Subject to the limitations set forth in subsection (a) above, a company may issue debentures that:

- i. provide that interest may be paid in the form of additional debentures, of the same class or another class of debenture;
- ii. provide for a fixed rate of interest, or a variable rate set according to a formula (defined prior to the creation and issuance of the debenture and established within the company's article of association).
- iii. provide a right to the debenture holder to sell the debenture back to the company at a specified price and within a specified time;
- iv. provide a right to the company to buy the debenture from the holder at a specified price and within a specified time; and
- v. provide a right to the debenture holder to convert the debenture into another class of security issued by the company (defined prior to the creation and issuance of the debenture and established within the company's article of association).

Comment [R2]: This language implements my recommendation to clarify a company's ability to issue debentures.

6. Prospectus and transfer of shares

Prospectus

(a) For purposes of Article 24, a prospectus shall be required for all public offerings of securities, as defined in this Regulation.

(b) Offers and sales of securities qualifying as private placements, as defined in this Regulation, shall be exempt from the prospectus requirement, provided that:

(i) the total amount of monies raised by sales of the subject class of securities during all offerings conducted by the issuer during any consecutive 12 month period does not exceed 1,500,000 MRf;

(ii) the total number of purchasers (excluding institutional investors) for the subject class of securities during all offerings conducted by the issuer during any consecutive 12 month period does not exceed 50; AND

(iii) all private placement transactions during the previous 12 month period have been reported to the Capital Market Development Authority in a format to be determined by the Authority.

(c) Schedule 2 of these regulations states the information to be included in a prospectus pursuant to section 26 and 27(d) of the Act.

7. ~~Securities Share~~ Transfer Form of a public company

(a) Form 8 prescribes the contents required to be there in the ~~securities share~~ transfer form of a public company.

(b) It shall be sufficient to have the essential information required by Form 8 for the purpose of ~~securities share~~ transfers.

8. Considerations for ~~securities shares~~

(a) Where ~~securities shares~~ are allotted for any consideration other than money, the following information shall be submitted to the registrar within 30 days.

- i. The contract(s) entered for the consideration of allotment of ~~securities shares~~, other than those contracts required by section 29 of the Act. Where there are no such contracts as a consideration for allotment of ~~securities shares~~, the documents, by Form 5 and 6, evidencing that the consideration has been received.
- ii. Where ~~securities shares~~ have been allotted for consideration other than money, information required by Form 7 of these regulations. The said form shall have details of valuation of the ~~securities shares~~ and the consideration received for its allotment. It shall also state that the value of the consideration is not less than the value of the ~~securities shares~~. The directors shall declare that this information is accurate.

Comment [R3]: The addition of this language helps delineate public offerings and private placements. It is necessary for the prospectus requirements and for implementation of the Reporting Company concept.

Comment [R4]: Given that companies can now issue preferred shares and debentures, it is more appropriate to speak in terms of "securities" instead of "shares" in some places.

(b) Where the registrar is of the opinion that the consideration is not a fair valuation of the ~~securities shares~~, the registrar may require the company to do valuation of ~~securities shares~~ by another competent party.

(c) Where ~~securities shares~~ are allotted for a consideration other than money and the value of the consideration is less than the face value of the ~~securities shares~~, it shall be deemed that the difference between the face value of ~~securities shares~~ and the value of the consideration is owed to the company.

9. Amendments to the rights attached to shares

The following provisions shall be complied with as per clause 30(b) of the Act.

(*) There shall be only one class of common shares, containing voting rights of one vote per share.

(*) There may be more than one class of preferred shares.

(a) Where shares of a company are divided into various classes, changes to the rights attached to those classes of shares could be brought only to the extent allowed by the memorandum and articles of association, and this section of these regulations.

(b) Rights attached to a particular class of shares could be brought only with prior approval of 75 percent shareholders of that particular class of shares, or with a special resolution of shareholders of that particular class of shares.

(c) After commencement of these regulations, any change to the rights attached to the shares as per the memorandum and articles of associations, could be brought only with the approval of 75% of shareholders, or with a special resolution of the shareholders.

(d) Where a resolution has been passed to decrease the voting power attached to a class of shares, or to decrease dividends available to a particular class of shares, it shall be deemed as an amendment to the rights attached to those shares.

(e) Where an amendment to the rights attached to a particular class of shares has been brought, the shareholders representing not less than 10% of that class of shares may apply to a Court to invalidate such amendments.

(f) Application referred in subsection (e) shall be made within 30 days of the amendment. A petition made by a shareholder with the approval of other shareholders shall be sufficient for this purpose.

(g) Any application made under this section to a Court shall be immediately notified to the Registrar

(h) With regards to the application made under this section, the Court may order any of the following

- i. Where it has been established that the amendments may diminish the rights attached to a particular class of shares, to invalidate such amendments
- ii. Where it has been established that the amendments do not diminish the rights attached to a particular class of shares, to uphold such amendments

(i) Where an order has been made by a Court as per subsection (h) the company shall file a copy of such order with the Registrar within 3 days.

***. Payment of Dividends**

(a) No dividends shall be paid on preferred or common shares unless all interest obligations due and owing by the company have been paid in full, except for interest obligations in dispute that have been submitted to a court or arbitration for resolution.

(b) No dividends shall be paid on common shares unless all dividends due and owing to preferred shareholders have been paid in full.

(b) Dividends on preferred and common shares may be paid from current earnings or retained earnings only.

Comment [R5]: This change relates to the seniority of securities issued by the company and it an attempt to add investor protection.

* * * *

12. Responsibilities of the Company secretary

Following shall be the responsibilities of the Company secretary, required under section 46(c) of the Act.

- i. Ensuring that all the necessary filings are made with the registrar, including the approval of the company name as per section 13 of the Act, amendments to the memorandum and articles of association as stated in section 19 of the Act, allotment of ~~securities shares~~ as per section 29 of the Act, allotment of ~~securities shares~~ for considerations other than money as stated in section 35 of the Act, increase of capital as per section 40 of the Act, decrease of capital as per section 41 of the Act, information pertaining to directors and secretary, information on registered address of the company, and annual financial statements as per section 69 of the Act.
- ii. Sending notices on all meetings of the company, and providing clarifications on such notices.
- iii. Attending to the meetings of the directors and meetings of the shareholders, and taking minutes of such meetings, and, along with Chairman, attesting the accuracy of such minutes.
- iv. Maintenance of the register of the shareholders, debenture holders, directors and secretaries. Where the company is a public company, maintenance of the register of major shareholders and register of mortgages.
- v. Maintenance of the financial statements with the guidance from directors, as per section 63 and 64 of the Act and approving the financial statements of the company, and making necessary arrangements for such financials to be presented to the Annual General Meeting, as per section 65 and 68 of the Act.
- vi. Maintenance of records of all transactions and documents of the company.

* * * *

16. Public companies to be listed

~~Where a public company sell shares to the public through a prospectus, such company shall be listed in an Exchange approved by Capital Market Development Authority.~~

* * * *

20. Interpretation

(a) Unless it is stated otherwise, the Act shall mean the Company's Act and the Registrar shall mean the Registrar of Companies.

(b) Unless it is stated otherwise, all words and phrases shall have the same meaning as given in the Companies Act.

~~(c) "public offering" shall mean any offer or sale of securities:~~

~~(i) to more than 50 persons;~~

~~(ii) to an undetermined number of investors;~~

~~(iii) made by use of general advertisement, the media and/or publication via the internet; or~~

~~(iv) resulting in more than 50 purchasers from the issuer, any member of the issuer's management, and/or significant shareholders of the issuer.~~

~~(d) "private placement" shall mean and offer or sale of securities:~~

~~(i) expressly confined to 50 persons or less;~~

~~(ii) made to qualified investors only; or~~

~~(iii) where the total offering is for 750,000 MRf or less.~~

~~(e) "qualified investor" shall mean any:~~

~~(i) commercial bank;~~

~~(ii) registered investment fund;~~

~~(iii) the Maldives Monetary Authority;~~

~~(iv) any person or entity designated as a "qualified investor" by the Authority under terms and conditions to be established by it~~

Comment [R6]: If the CMDA accepts my suggestion to create the concept of reporting company this provision should be eliminated. Reporting will be required under the SA and Regulation on Continuing Disclosure Obligations. The securities can either be listed voluntarily or admitted for trading independently by the MSE.]

Comment [R7]: The addition of this language helps delineate public offerings and private placements. It is necessary for the prospectus requirements and for implementation of the Reporting Company concept.

DESCRIPTION OF CORPORATE BONDS

SUGGESTED LANGUAGE

The following language could be inserted into the Company General Regulation or the Draft Regulation on Issuance of Securities.

PART 1: CORPORATE BONDS

1. Corporate debt issued in the form of a security may not be described, marketed, offered or sold as a “bond” or “debenture” unless the terms and conditions contained in this Part are met.

Terms, Rights and Conditions of Bonds

2. The issuance of a corporate bond, including all of its terms, rights and conditions, shall be approved by a resolution of the company adopted by (a) the company’s Board of Directors, or (b) if the articles of association require, then by the shareholders of the company at a general or extraordinary meeting.
3. Corporate bonds shall be created by a bond indenture which shall contain:
 - a. A description of the terms, rights and conditions of the bonds;
 - b. A master promissory note evidencing the indebtedness of the company to the bondholders;
 - c. The creation of fractional, undivided interests in the master promissory evidenced by the bonds so created;
 - d. Appointment of a bondholder’s representative;
 - e. Adoption of a contract between the bondholders' representative, the issuer, and any guarantor of the bonds;
 - f. Description of assets pledged as collateral (security) for the bonds, where applicable;
 - g. Description of guarantees of performance of the bonds, where applicable; and
 - h. Any further information necessary for the establishment, issuance, transference of the bonds and the supervision of the company’s compliance with its obligations.
4. Each bondholder within a class of bonds shall be granted full and equal rights with all other bondholders of the same class.
5. Ownership of corporate bonds shall be recorded in dematerialized form at the Maldives Securities Depository and assigned an identification number. Corporate bonds may not be issued in certificated form.

Role of the Bondholders’ Representative

6. The bondholders’ representative shall be responsible for monitoring the issuer’s compliance with the bond indenture and all related contracts and agreements.
7. The bondholders’ representative shall not be an affiliate of the issuer, of members of the issuer’s Board of Directors or of the issuer’s management.
8. The bondholders’ representative shall be identified and described (a) within the resolution authorizing the issuance of the bonds, but no later than (b) within the bond

- indenture. The bondholders' representative shall conduct its activities according to the contract of appointment included within the bond indenture.
9. If it appears that the issuer is not performing its obligations under bonds, the bondholders' representative, on its own initiative or based on written request of any of the bondholders addressed to the bondholders' representative, may investigate the facts of the apparent failure. The issuer shall cooperate fully with such an inquiry, produce all records requested by the bondholders' representative and make representatives from the issuer available for interviews. Failure to cooperate with a bondholders' representative inquiry shall constitute, in the bondholder representative's own discretion, a default of the bonds.
 10. In cases where the bondholders' representative determines that the bond indenture has been violated, or is likely to be violated, the bondholders' representative shall be authorized to take any and all action necessary on behalf of the bondholders to protect their rights.
 11. The bondholders' representative shall be compensated by the issuer in accordance with the contract. The bondholder representative's compensation shall include reimbursement for all necessary and reasonable expenses incurred in performing its duties. In the event of insolvency of the issuer, any unpaid portion of the bondholder representative's compensation and expenses shall be deemed an "expense incurred for the winding up" as used in Company Act Article 91 and shall take priority over other payments.
 12. The bondholders' representative may be replaced only with consent of the Authority. If a bondholders' representative commits actions or inactions contrary to the requirements of the legislation, regulations thereunder, the emission prospectus or bond indenture, the Authority may allow the issuer to replace the bondholders' representative or require on its own initiative that the issuer to replace such bondholders' representative.
 13. A bondholders' representative shall not be liable for any damage caused by its actions or inactions during execution of its rights and obligations, provided that the detrimental conduct does not constitute illegal or negligent acts.

PART 2: SECURED BONDS

14. Corporate bonds may not be described, marketed, offered or sold as a "secured" unless the terms and conditions contained in this Part are met.
15. The value of collateral pledged with respect to secured bonds shall not be less than total face value of bonds. In the event that the collateral is destroyed or damaged, it shall be replaced with assets of similar or higher quality and same or higher value. The replacement of collateral shall be approved by the BR in its sole discretion. The failure by the issuer to replace destroyed or damaged collateral shall be deemed, in the bondholder representative's sole discretion, a default of the bonds.
16. Bonds may be secured with a pledge interest in investment securities, certificates of deposit, title to real estate, mortgages, financial leases, and title to movable assets. Any asset used as collateral must have a registered right of ownership evidenced and contained within a registry maintained in the Maldives, within any of the atolls, or within a foreign state registry.

17. If ownership of secured bonds is transferred, the rights with respect to pledge collateral shall also be deemed transferred. The transfer of secured bonds with the purported lack of transfer of rights in the collateral shall be considered invalid and the rights in the collateral shall be deemed to be transferred with ownership of the bonds.
18. The bondholders' representative shall act as the holder of the pledged collateral securing the bonds in its name for the benefit of the bondholders.
19. The pledge of property shall be recorded and perfected in accordance with procedures provided for asset pledges in the legislation.
 - a. In the case of real estate, and mortgages on real estate, the pledge shall be recorded by process within the courts;
 - b. In the case of investment securities, ownership of the securities shall be converted to dematerialized form at the Maldives Securities Depository and the pledge recorded in those records;
 - c. In the case of certificates of deposit, term deposits or fixed deposits, the pledge shall be recorded at the issuing financial institution, together with an instruction by the bondholders' representative (and consent by the account holder) that the balance shall not be transferred to the account holder upon maturity and that the bondholders' representative shall have the authority to proscribe disposition of the funds;
 - d. In the case of mortgages on non-real estate, financial leases and title to movable property, the pledge shall be recorded in the registry that records ownership in the asset;
 - e. In the case that any registry cannot record or properly implement the pledge (in the sole discretion of the bondholders' representative) then the pledge shall be perfected by taking physical custody of the ownership certificate and notifying the registry of same.
20. Property and pledge interests held by an entity or person in its role as bondholders' representative shall not be deemed to be property in the sole title or beneficial ownership of the bondholders' representative and shall not be available to the creditors of the bondholders' representative for satisfaction of the bondholder representative's debts.
21. The bondholders' representative shall be entitled to foreclose on the pledge of the collateral if (a) the issuer defaults on a required interest payment, or (b) the issuer is placed in bankruptcy, whichever occurs first. If the issuer is placed in bankruptcy, the secured bondholders shall be entitled to priority over other creditors of such issuer in acquiring title to the subject collateral. Upon receiving title to the collateral the bondholders' representative shall sell the asset, using its discretion to obtain the highest value possible.
22. Revenues from sale of pledged property shall be provided to the secured bondholders in exchange for redemption of their bonds. If revenues from sale of pledged property are greater than the face amount of secured bonds outstanding, this difference shall be paid to the issuer or to the bankruptcy administrator. If revenues from sale of pledged property are less than the face amount of secured bonds outstanding then the bonds shall be redeemed on a pro rata basis and the bondholders shall be deemed unsecured creditors for the remainder amount.

PART 3: GUARANTEED BONDS

23. Corporate bonds may not be described, marketed, offered or sold as a “guaranteed” unless the terms and conditions contained in this Part are met.
 24. If a guarantee with respect to ensuring the performance of the bonds is provided, the guarantor shall issue the guarantee as part of the bond indenture.
 25. A guarantee presented for ensuring performance of obligations under bonds shall be registered in the manner prescribed by the legislation.
 26. The procedure for obtaining a guarantee from the government of Maldives, or any subdivision thereof shall be regulated in accordance with respective legislation.
 27. A guarantee presented for ensuring performance of obligations of bonds shall not be withdrawn without the consent of the br. The bondholder representative’s consent may be conditioned on the issuer’s obtaining another guarantee or similar or higher value.
 28. In the event that the guarantee lapses outside the control of the bondholders’ representative, the bondholders’ representative shall require that the issuer immediately obtain a similar or higher value guarantee. Failure of the issuer to obtain such a guarantee shall constitute, in the sole discretion of the bondholders’ representative, a default of the bonds.
-

COVERED BONDS SUGGESTED LANGUAGE

The following language could be inserted into the Company General Regulation or the Draft Regulation on Issuance of Securities. It is drafted to be inserted in the suggested language for corporate bonds and should be placed in the same location within the Maldives regulations

PART 4: COVERED BONDS

General Provisions

1. Bonds may not be described, marketed, offered or sold as a “covered bonds” or “mortgage bonds” unless the terms and conditions contained in this Part are met.
2. Covered bonds may be issued only by the following institutions operating in the Maldives: (a) commercial banks, (b) mortgage finance companies, (c) leasing companies, and (d) other institutions approved by the Maldives Monetary Authority.
3. Covered bonds are created by placing a group of pledged assets to serve as collateral for the bond obligation (the collective collateral described below as the “cover pool”). The content of the cover pool shall not be fixed, but shall be adjusted as required to maintain the specified minimum level of collateral protection for the bonds.
4. The provisions relating to secured bonds shall apply with equal force to covered bonds, unless such application is inconsistent with the specified provisions.

Disclosure of Terms

5. The following information shall be included in the offering prospectus of covered bonds, in addition to those requirements stipulated by the Securities Act (and regulations adopted thereunder) and the Company Act (and regulations adopted thereunder):
 - a. information on assets included in the cover pool (their value, composition, terms and procedures of debt payment); and
 - b. information concerning the procedures for replacing defaulted, impaired or redeemed cover assets.

Permissible Cover Assets

6. Only the following types of assets may be included in the cover pool for covered bonds:
 - a. Mortgages on residential real estate located within the Maldives;
 - b. Mortgages on commercial real estate located within the Maldives;
 - c. Financial leases concerning property with ownership registered in the Maldives;
 - d. Investment securities issued by Maldivian companies or Maldivian limited liability partnerships;
 - e. State securities of the Republic of Maldives; and
 - f. Securities issued by the Maldives Monetary Authority;

7. The following assets may be also be used as cover for covered bonds, provided that their total value does not exceed twenty percent (20%) of the total cover value for the bonds:
 - a. Term deposits held at commercial banks licensed by the MMA (or at financial institutions approved by the MMA) each with a remaining maturity of 180 calendar days or less; and
 - b. Treasury securities issued by the Republic of Maldives each with a remaining maturity of 180 calendar days or less;
8. Cover assets must:
 - a. be denominated in the same currency as the covered bonds;
 - b. either: (i) all pay (yield) fixed interest or dividends, or (ii) all pay (yield) variable interest or dividends;
 - c. collectively, have a remaining term (maturity), calculated on the weighted average method, longer than the remaining maturity of the covered bonds; and
 - d. collectively, generate an income stream that is (i) greater than the amount necessary for the payment of the stated interest on the covered bonds, (ii) paid in sufficient frequency and timing to allow payment of covered bond interest as it becomes due.
9. The Authority may prescribe the method for the weighted average formula to be used for purposes of the point immediately above.
10. In the event that mortgages or financial leases are used a cover assets, the assessed value of the cover asset shall not exceed eighty percent (80%) of estimated market value of the underlying property.
11. The value of the cover assets shall at all times be at least one hundred twenty per cent (120%) of the outstanding principal amount of the covered bonds.
12. The following may not be used as cover assets:
 - a. rights under mortgages or leases secured by (i) raw land, or (ii) land with construction in process; or
 - b. rights under loans classified under regulations of the MMA as non-performing.
13. Assets underlying mortgage or financial lease rights included in the cover shall be insured against risk of destruction or damage for benefit of mortgagee / lessor (i) for a period at least as long as the obligation, and (ii) in an amount not less than remaining value of the mortgage or lease.
14. Mortgage and financial lease contracts included in the cover shall include terms (i) prohibiting transfer or disposal of the underlying property without consent of mortgagee or lessor (except by transference through inheritance), and (ii) prohibiting actions inflicting damage on the underlying property or resulting in its impairment.

Covered Bond Interest Rates

15. Covered bonds shall pay interest at least annually.
16. If assets included in the cover pay fixed interest and/or dividends, the interest rate on covered bonds shall be fixed.

17. If assets included in the cover pay variable interest and/or dividends, the interest rate on mortgage bonds shall be variable, with the interest payable calculated using the same benchmark value as the cover assets. In the event that the cover assets use differing benchmarks values, the Authority shall approve the benchmark calculation method for interest to be paid by the covered bonds.

Cover Pool Asset Registry

18. Each issuer of mortgage bonds shall establish a registry of the cover assets securing its bonds. Each issue of covered bonds by an issuer shall be secured with a separate cover pool.
 - a. Assets shall be deemed to be included in cover pool immediately after an appropriate note is made in a registry of cover assets.
 - b. The following information shall be included in a registry of cover assets:
 - i. requisites of documents confirming the bond issuer's rights with respect to the cover assets;
 - ii. terms of the cover assets including principal debt and interest rate, periods of payment, or terms enabling to calculate these sums;
 - iii. performance status of cover assets;
 - iv. name, description, and location of property associated with mortgages or leases included in the cover pool;
 - v. value of underlying property associated with mortgages or financial leases included in the cover pool;
19. The bondholders' representative may require additional aspects and content of the registry of cover assets.

Management of the Cover Pool

20. Assets in the cover pool shall be pledged in the name of the bondholders' representative for the benefit of the bondholders. Unless and until foreclosure on the pledge of a cover asset, the cash inflow from that asset shall be paid to the issuer, which may use the income at its own discretion.
21. Pledges of assets shall be recorded and perfected by the issuer and bondholders' representative in the same manner as for secured bonds.
22. Assets included in the cover pool shall not be pledged, mortgaged, otherwise encumbered sold or disposed without the authorization of the bondholders' representative.
23. The bondholders' representative shall be entitled to permit disposal of assets included in the cover pool only if it does not contradict the law, the terms of the bond indenture and the content of the offering prospectus.
24. Unless a shorter period is established by the bond indenture or offering prospectus, the bondholders' representative shall verify at least semi-annually the compliance of the cover assets with the following requirements:
 - a. eligibility of the asset to be included in the pool;

- b. the proportion limits between cover assets (fixed and current assets);
- c. the ratio limits between the assessed value of the cover asset to the underlying asset (if any);
- d. the minimum ratio of total cover value to total remaining principal value of the covered bonds; and
- e. adequacy of payment period and payment amounts derived from the cover pool compared to the required interest to be paid by the covered bonds.

The results of the compliance review shall be transmitted to the issuer and the Authority.

- 25. If the cover pool does not comply with (i) the requirements of the legislation, (ii) the terms of the bond indenture, and/or (iii) the statements made in the offering prospectus, the bondholders' representative shall inform the issuer in writing and demand that the issuer cure the deficiency. A copy of the notice shall be sent to the Authority. The issuer shall cure all deficiencies no later than 10 calendar days from the date of demand and provide the bondholders' representative with appropriate information and documents relating to this matter.
- 26. In the event that assets in the cover pool (i) are defaulted upon; (ii) deteriorate in value (in the sole discretion of the br); or (iii) are redeemed, the br shall have the authority to require the issuer to substitute additional cover assets fulfilling the eligibility criteria. The issuer shall supply the replacement cover asset(s) no later than 10 calendar days, or such later deadline as specified by the bondholders' representative if found to be in the best interest of the bondholders.

Impairment or Default of the Covered Bonds

- 27. If it appears that the issuer is not performing its obligations under bonds, the bondholders' representative, on its own initiative or based on written request of any of the bondholders addressed to the bondholders' representative, may investigate the facts of the apparent failure. The issuer shall cooperate fully with such an inquiry, produce all records requested by the bondholders' representative and make representatives from the issuer available for interviews. Failure to cooperate with a bondholders' representative inquiry shall constitute, in the bondholder representative's own discretion, a default of the bonds.
- 28. In cases where the bondholders' representative determines, in its sole discretion, that the applicable law, the bond indenture (or any document comprising the indenture) and/or the offering prospectus has been violated, or is likely to be violated, the bondholders' representative shall be authorized to take any and all action necessary on behalf of the bondholders to protect their rights.
- 29. Funds received from sale of cover assets shall be allocated as follows:
 - a. payment of liabilities incurred in connection with the sale of the cover asset(s);
 - b. fulfillment of liabilities under bonds.

Any remaining portion of funds shall be forwarded to the issuer, or in the case of a pending bankruptcy proceeding, to the bankruptcy administrator.

Partnership Act
Law number 13/2011

Title 1.–(1) This Act shall govern the formation, registration, operation and other applicable principles of partnerships in Maldives.
 (2) This Act shall be cited as “Partnership Act of Maldives”

* * * *

Chapter 2
Formation and Operations of Partnerships

Number of partners ~~6. The number of partners in a partnership shall not be more than 20.~~
6. Unless specified to the contrary in the partnership agreement, the number of possible partners in a partnership shall not be limited.

* * * *

Managing partner 10.–(1) Every partnership shall have a managing partner. ~~For limited liability partnerships, the managing partner may be a natural person or legal entity.~~

(2) The managing partner shall be responsible for the operations and management of the partnership subject to this Act, regulations made under this Act and the partnership agreement.

(3) Managing partner shall be ~~a natural person~~ resident in Maldives.

Responsibilities of the Managing Partner 11. Managing Partner shall –
(a) Notify the Registrar any change in the particulars of the Partnership within 7 days from that change.
(b) Shall pay all necessary fees and fines in relation to the partnership accordingly as required.
(c) Shall be responsible for all communications necessary with the Registrar in relation to the partnership.
(d) Shall be responsible for other duties of the Managing partner as stated in the Regulations made under this Act, and in the Partnership Agreement.

~~(e) with regard to a limited liability partnership, be liable for debts and other obligations of the partnership.~~

Issuance of Debentures Partnerships registered as a LLP may offer and sell debentures under terms defined in the General Regulation.

Payment of Dividends No distributions shall be made to limited or general partners unless all interest obligations due and owing by the LLP have been paid in full, except for interest obligations in dispute that have been submitted to a court or arbitration for resolution.

Comment [R1]: This change is necessary to allow the more widespread use of the LLP as a legal form. It is also necessary to allow use of LLP as legal form for investment funds.

Comment [R2]: This change is necessary to better enable the use of LLPs by allowing legal entity managing partners.

Comment [R3]: This change helps align the relative liabilities between the managing partner and the limited partners.

Comment [R4]: This language is designed to make clear a LLP's ability to issue debentures.

* * * *

Sharing of profit and loss

23.—(1) In a general partnership, profit and loss of the partnership shall be shares among the partners in the proportion in which the partners have contributed or agreed to contribute money, or some service rendered towards the capital of the partnership, and in the manner stated in the partnership agreement.

(2) In a limited liability partnership, profit shall be shared among the partners in proportion to the capital agreed to contribute or obligations agreed to be shared, and as stated in the partnership agreement.

~~(3) In a limited liability partnership, the partners shall be responsible for the liabilities of the partnership to the extent of any payment outstanding to the partnership for the shares taken or agreed to be taken, or to the extent agreed to be responsible for the liabilities of the partnership.~~

(3) In a limited liability partnership, a limited partner shall be responsible for the liabilities of the partnership to the extent of (a) his/her/its paid-in capital for the shares, plus any unpaid amount due under the subscription agreement for the shares, or (b) a greater amount to the extent as agreed within the partnership agreement.

Comment [R5]: Current Article 23(3) could be read to set the maximum liability only for the amount paid for the shares. If they are only partially paid then this would be an incorrect result. The proposed language is designed to cure the ambiguity.

Scope of responsibilities of partners

24.—(1) Every partner of a general partnership, for the purpose of the business of the partnership, shall be considered as agent of the other partners, and any transaction done by a partner in the ordinary course of the business of the partnership shall bind the other partners.

(2) ~~Every partner~~ The managing partner of a limited liability partnership, for the purpose of the business of that partnership, shall be considered as ~~an~~ the sole agent of the partnership as a whole, and any transaction done by a partner in the ordinary course of business shall be binding on the partnership as a ~~whole~~.

Comment [R6]: If the managing partner is the only partner with unlimited liability for the LLP's obligations it does not make sense to allow limited partners to act as agents for the LLP and incur obligation sfor which they are not liable.

* * * *

Court order for dissolution of a partnership

40. Where a partner has filed a petition in a Court to dissolve a partnership, the court may order dissolution if the following circumstances

(a) Where a partner of the partnership is proved to be insane.

(b) Where a partner has become permanently disabled to perform his function as stipulated in the partnership agreement

(c) Where a partner has committed an offence that would cause a substantial loss to the partnership taking into consideration the entire business being carried only the partnership

(d) Where a partner has purposely or repeatedly breached the partnership agreement or it has become difficult to carry on the business of the partnership by having a particular partner in the partnership

(e) Where the business of the partnership could not be carried except at loss

(f) Where the court finds that the dissolution of the partnership is just.

Appendix E: Partnership Act Amendments

Seniority of Claims

The assets of a partnership in a dissolution process shall be applied, after deducting the expenses incurred for the remuneration of the person(s) appointed to dissolve the partnership, in the following order.

- (a) Money due to the government or to government bodies.
- (b) Wages due to the employees of the partnership except general or limited partners for three months from the date the court issued the dissolution order or the partnership passed the special resolution to dissolve the partnership.
- (c) Monies due to secured creditors, to the extent of the value of the collateral pledged to them, with any remaining unpaid obligation considered to be unsecured.
- (d) Monies due to unsecured creditors in pari passu.
- (e) Any remaining balance to be paid to the partners, according to the rights set out in the partnership agreement.

Comment [R7]: This section is designed to make the seniority of the debentures clear.

SUGGESTED LANGUAGE FOR PARTNERSHIP GENERAL REGULATION

The following language could be inserted into the Partnership General Regulation as enabling material for the suggested amendments to the Partnership Act included in the Report.

*. **Categories of Permitted Debentures**

- (a) Partnerships registered as limited liability partnerships (“LLP”) shall be permitted to issue debentures.
- (b) A LLP may issue debentures that:
 - i. provide that interest may be paid in the form of additional debentures, of the same class or another class of debenture;
 - ii. provide for a fixed rate of interest, or a variable rate set according to a formula (defined prior to the creation and issuance of the debenture and established within the LLP’s partnership agreement).
 - iii. provide a right to the debenture holder to sell the debenture back to the LLP at a specified price and within a specified time;
 - iv. provide a right to the LLP to buy the debenture from the holder at a specified price and within a specified time; and
 - v. provide a right to the debenture holder to convert the debenture into (a) a limited partnership interest, or (b) another class of debenture issued by the LLP (defined prior to the creation and issuance of the debenture and established within the LLP’s partnership agreement).
- (c) Debentures may be denominated in a foreign currency.

Comment [R1]: This language implements my recommendation to allow LLPs to issue debentures.

MARKED TEXT BUSINESS PROFITS TAX ACT

For purposes of this Report, the sections of the current Business Profits Tax Act that have not been revised are omitted from this version.

**Law Number:
5/2011**

Unofficial Translation

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BUSINESS PROFIT TAX ACT

Introduction and citation

1. (a) This Act contains provisions for the establishment and implementation of an administrative framework for the purpose of implementing Business Profit Tax in Maldives.
- (b) This Act shall be cited as the “Business Profit Tax Act”.

* * * *

Charge to business profit tax: partnerships

5. (a) The following provisions shall apply in relation to a partnership in a tax year, whether or not it is registered under the Partnership Act (Act Number 9/96):
 - (1) The taxable profits of the partnership of that year, or any losses, shall be computed as if it were a body corporate;
 - (2) Business profit tax shall be charged in the name of the partnership;
 - (3) A partner in such a partnership shall not be charged to tax in respect of his share of the profits nor shall any loss accruing to him from the partnership be brought into account in computing the tax liability of the partner;
 - (4) ~~Every Person who is a partner in that year shall be jointly and severally liable to pay any tax due and payable under this Act in respect of those profits.~~
Every partner in a general partnership who is a partner in that year shall be jointly and severally liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were partners.
 - (5) Any managing partner of a limited liability partnership shall be liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were managing partners.
 - (6) Limited partners of a limited liability partnership shall not be liable for the tax obligation of the partnership, except to the extent that payment of the liability results in the dissolution of the partnership and then only to the extent of liability specified

Comment [R1]: These changes are necessary to conform the BPT with Partnership Act Articles 30(4) and 23(3).

These changes also reinforce that the liability of limited partners is in fact limited and that the general partner bears the liability for the LLP's obligations.

in the Partnership Act.

- (b) In computing the taxable profits of any partnership, no deduction shall be made in respect of any payments to partners of a share in the partnership profits or of the interest on partner's capital.

* * * *

Other amounts
not deductible

11. (a) Without prejudice to the generality of Section 10(a), in computing a Person's taxable profits for a tax year, a deduction shall not be allowed in respect of:
- (1) domestic or private expenses;
 - (2) capital expenditure including the cost of any improvement, alteration or addition to a capital asset except as may be provided by regulations;
 - (3) rent of or expenses in connection with any premises or part of any premises not occupied or used for the purpose of producing the profits;
 - (4) rent of any premises owned or leased by that Person and used by him in connection with the carrying on of his business except as may be allowed by regulations;
 - (5) interest if and to the extent that it is payable at a rate exceeding 6% (six percent) per annum except interest payable to a bank or financial institution approved by the MIRA, or made to service debt obligations relating to a debt security issued, or guaranteed by, the taxpayer, provided however that the debt security is listed or admitted for trading upon a securities exchange licensed by the Capital Markets Development Authority for operation within the Maldives;
 - (6) a fine or interest payable in respect of any failure to comply with any law, including this Act and regulations made pursuant to it.

* * * *

Chapter 2

Exemptions from Tax

Exemption for
banks, charities
and foreign
investments

15. (a) The provisions of this Act, apart from this Section, do not apply to the following Persons:
- (1) the Maldives Monetary Authority;

Comment [R2]: This change is necessary to make the interest on corporate bonds deductible

Appendix G: Business Profits Tax Act Amendments

- (2) any bank which is within the charge to bank profits tax under the Law on Taxing Profits of Commercial Banks operating in Maldives (Act Number 9/85);
- (3) any body, association or public institution which is approved by the MIRA and established for the promotion of Islam, relief of the poor, medical relief or education or any other object of similar general public utility.
- (b) A Person who is party to an agreement under the Law on Foreign Investments in Maldives (Act Number 25/79) made after the commencement day shall be exempt from tax under this Act to the extent that the agreement confers such an exemption
- (c) Exemptions from tax purported to be granted under such agreements before commencement day shall be of no effect for the purposes of this Act.
- (d) The MIRA shall have the authority to issue regulations governing the taxation of investment funds regulated by the Capital Markets Development Authority, including exemption from taxation under this Act and other Acts related to taxation, under specified conditions.

Comment [R3]: This change is necessary to allow setting the tax regime for investment funds by rule rather than amending the BPT.

* * * *

Chapter 6

General and Supplementary Provisions

- | | |
|-------------------------------------|---|
| Commencement of the Act | 41. Commencement of this Act will be upon 6 (six) months of passing, ratification and publication in government gazette. And this Act shall apply for the charge to tax, on the date of commencement of this Act or, for the tax years beginning thereafter. |
| Administration and make regulations | 42. (a) Unless otherwise stated in this Act, the Act will be administered and regulations be made by the MIRA. The regulations pursuant to this Act shall be made within 6 (six) months from the commencement of this Act.

(b) <u>The MIRA shall have the authority to issue regulations governing the taxation of investment funds regulated by the Capital Markets Development Authority, including exemption from taxation under this Act and other Acts related to taxation, under specified conditions.</u> |

Comment [R4]: This change is necessary to give the MIRA the authority to adopt a regulation on investment funds and thus allow setting the tax regime by rule, instead of law amendments.

MARKED TEXT OF REGULATION ON CONTINUING DISCLOSURE OBLIGATIONS OF ISSUERS

For purposes of this Report, the sections of the current Regulation that have not been revised are omitted from this version.

SECURITIES (CONTINUING DISCLOSURE OBLIGATIONS OF ISSUERS)
REGULATIONS 2010

In exercise of the powers conferred by Section 60 of the Maldives Securities Act 2/2006 the Capital Market Development Authority has made the following regulations;

**PART I
PRELIMINARY**

1. **Citation**

These regulations may be cited as the Securities (Continuing Disclosure Obligations of Issuers) Regulations 2010 and shall come into force on 1st January 2011.

2. **Interpretation**

In these Regulations unless the context otherwise requires any term defined in the Securities Act for which there is no definition in these Regulations shall have the meaning assigned to it by that Act-

"accounting period" means the period in respect of which the financial accounts of the issuer are made up, whether that period is a year or not;

"Act" means the Maldives Securities Act 2/2006;

"associate", in relation to any director or chief executive, means

- (a) his spouse, children or any company, trust or other entity controlled by any of them
- (b) any company of which he is a director, and
- (c) any employee,

and a reference in these regulations to an associated person or associated company shall be construed accordingly;

"board" means board of directors of the issuer;

"chief executive", in relation to an issuer, means an employee of that issuer who, alone or jointly with one or more others, is responsible under the immediate authority of the directors, for the conduct of the whole of the business of that issuer;

"company" shall mean any company formed under the Company Act Law No. 10/1996

"interest in securities" means any legal or equitable interest or right in relation to a security, including

- (a) an absolute or contingent right to acquire a security created, allotted or

Comment [R1]: This is necessary to include for purposes of part (c) of the definition of reporting company, because that subpart is limited to domestic companies.

Appendix H: Regulation on Continuing Disclosure Amendments

issued or to be created, allotted or issued; and

- (b) the interests or rights of a person for whom a security is held on trust or by a custodian or depositary

LLP shall mean a limited liability partnership formed under the Partnership Act Law No. 13/2011

"member", in relation to an issuer, means a shareholder whose name is entered in the company's register of members;

"issuer" shall mean any company or LLP required to make disclosures under this Regulation.

"Reporting Company" means:

- (a) Any entity (domestic or foreign) which has its securities listed on a securities exchange licensed to operate within the Republic of Maldives
- (b) Any entity (domestic or foreign) which has conducted a public offering of securities within its last three fiscal years
- (c) Any company or LLP that has more than 50 owners of any of its outstanding class of securities.

"securities" shall have the meaning ascribed in the Act, and shall include units issued to limited partners in a limited liability partnership formed under the Partnership Act and shares (units) issued by investment funds.

"substantial shareholder" means a person who holds by himself or his nominee, a share or an interest in a share which entitles him to exercise not less than 5% of the aggregate voting power exercisable at a meeting of shareholders.

3. Application

- (1) These Regulations apply to any issuer that is a Reporting Company the issuers of securities which are listed on the Stock Exchange.
- (2) An issuer's obligation under this Regulation to provide notices, communications and reports to the Stock Exchange shall apply only if the issuer has a class of securities listed on the Exchange.
- (3) An issuer that is a Reporting Company solely by virtue of subpart (c) of that definition shall be exempt from the Quarterly Reporting Requirements of Section 7, provided that the issuer does not have more than 100 owners of any of its outstanding classes of securities.

17. Action against issuer

- (1) Where the Authority considers that an issuer has contravened or failed to comply with any of these Regulations, the Authority may take one or more of the following actions
 - (a) impose a penalty on the issuer up to a maximum of MRF30,000;
 - (b) privately censure the issuer

Comment [R2]: This is necessary to include for purposes of part (c) of the definition of reporting company because that subpart is limited to domestic LLPs.

Comment [R3]: This is necessary in order to avoid changing "issuer" to "reporting company" throughout the text.

Comment [R4]: Since limited partnership units are included in the definition of securities this term covers all instruments.

Rather than suggest amending the SA at Article 62, I am suggesting including this language here and for the Regulation on Issuances.

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Appendix H: Regulation on Continuing Disclosure Amendments

- (c) publish the fact that the issuer has been penalised or censured for contravening these regulations
 - (d) In cases where the issuer has any class of security listed or admitted for trading on the Exchange, direct the Stock Exchange ~~on which the issuer is listed to suspend trading in any or all classes of securities of the issuer.~~
 - (i) ~~to suspend trading in the securities of the issuer~~
 - (e) In cases where the issuer has a class (or classes) of securities listed on the Exchange
 - (ii) to suspend the listing(s) of those securities the issuer
 - (iii) to delist one or more of the classes of securities the issuer
- (2) In the event of an issuer being penalised under paragraph 1 (a), the company must disclose details of the penalty in its audited accounts relating to the period in which the fine is imposed.
- (3) A penalty under this section is payable to the Authority.

MARKED TEXT OF DRAFT REGULATION ON ISSUANCES

For purposes of this Report, the sections of the draft Regulation that have not been revised are omitted from this version.

REGULATIONS ON ISSUANCE OF SECURITIES 2011

These regulations are made in exercise of powers conferred on the Capital Market Development Authority by section 60(a) and 42 of the Maldives Securities Act (Law No: 2/2006).

1. Introduction, Citation and Commencement

- (1) These regulations govern the issuance of any securities to the public by any issuer unless these regulations state otherwise
- (2) These regulations may be cited as the Regulations on Issuance of Securities 2011
- (3) These regulations shall come into effect once published in the Gazette of the Republic of Maldives

2. Scope

- (1) ~~Any issue, offer or invitation to the public shall be accompanied by a prospectus which shall comply with these regulations.~~
A prospectus submitted and disseminated in compliance with this Regulation shall be required for all public offerings of securities.
- (2) ~~Subject to paragraphs (4) to (6), these regulations shall apply to:~~
Offers and sales of securities qualifying as private placements shall be exempt from the requirements of this Regulation, provided that:
 - (a) ~~Any issuance of securities of a class which are listed on a stock exchange~~
the total amount of monies raised by sales of the subject class of securities during all offerings conducted by the issuer during any consecutive 12 month period does not exceed 1,500,000 MRF;
 - (b) ~~Any issuance of securities of a class for which listing is sought from a stock exchange~~
the total number of purchasers (excluding institutional investors) for the subject class of securities during all offerings conducted by the issuer during any consecutive 12 month period does not exceed 50; and
 - (c) ~~Any listing on a Stock exchange regardless of whether there was any offer or issuance of any securities.~~
all private placement transactions during the previous 12 month period have been reported to the Capital Market Development Authority in a format to be determined by the Authority.
 - (d) ~~Any other offer of securities or invitation to subscribe to the securities to the public.~~
- (3) ~~In these regulations, an offer or invitation shall be construed as an offer or invitation to the public where:-~~
 - (a) ~~Offer is made to or securities may be bought by any person of the public (including any section of public); or~~
 - (b) ~~The offer is made to, or where there would be allotments made to more than 50 persons in one calendar year.~~
- (4) These regulations shall not apply to any offer/issue of securities where:
 - (a) The issuer is the Government of Maldives or any Agency representing the Government of Maldives or any Public Authority.
 - (b) ~~Where the issue or offer is by way of private placement in which the Authority is satisfied that the offer is not open to the public or a section of the~~

Appendix I: Regulation on Issuance Amendments

~~public.~~

- (5) These regulations do not exempt any corporation from the applicable regulations in relation to prospectus requirements under the Companies Act of the Maldives
- (6) Where the proposal by the issuer is for issuance of Islamic securities, additional guidelines issued by the Authority in relation to such issuance shall apply.

2. **Interpretation**

In these regulations:

“Act” means the Maldives Securities Act 2/2006;

“Authority” means the Capital Market Development Authority under the Maldives Securities Act 2/2006;

“expert” includes engineer, valuer, accountant and any other person whose profession gives authority to a statement made by him; and

‘issuer’ has the meaning ascribed to it in the Act

“Principal adviser” has the meaning ascribed to it in the Guidelines on Principal Adviser.

“Prospectus” means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of securities of, a body corporate .Where a company allots or agrees to allot securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company ; and all enactments and rules of law as to the contents of prospectuses and as to liability in respect of statements in and omissions from prospectuses, or otherwise relating to prospectuses, shall apply and have effect accordingly.

“public offering” shall mean any offer or sale of securities:

(a) to more than 50 persons;

(b) to an undetermined number of investors;

(c) made by use of general advertisement, the media and/or publication via the internet; or

(d) resulting in more than 50 purchasers from the issuer, any member of the issuer’s management, and/or significant shareholders of the issuer.

“private placement” shall mean and offer or sale of securities:

(a) expressly confined to 50 persons or less;

(b) made to qualified investors only; or

(c) where the total offering is for 750,000 MRf or less.

“qualified investor” shall mean any:

(a) commercial bank;

(b) registered investment fund;

(c) the Maldives Monetary Authority;

(d) any person or entity designated as a “qualified investor” by the Authority under terms and conditions to be established by it

‘Securities’ has the meaning ascribed to it in the Act, and shall include units issued to limited partners in a limited liability partnership formed under the Partnership Act and shares (units) issued by investment funds.

Comment [R1]: Rather than propose amending the SA at article 62, I have added this here and to the Regulation on Continuing Disclosure.

COMMENTS TO CPT AND PIT TAX BILLS

A review of the Corporate Profits Tax and Personal Income Tax Bills indicates that some adjustments are needed to implement the tax-related recommendations contained in the Report. However, because these are Bills only, and not part of the current applicable law, the suggested revisions were not placed in the Report. The following summarizes suggested revisions to the CPT and PIT made in Memoranda I submitted dated September 8th and 21st.

I. TAX TREATMENT OF CORPORATE DEBT

Currently the Business Profits Tax does not allow deduction of interest paid on corporate debt securities. But interest paid on bank loans is deductible. See Article BPT 11(a)(5). This is carried over to the pending CPT Bill at Article 52. I suggest revising Article 52(a) as follows:

(a) Any amount of interest made to a bank or a financial institution approved by the MIRA, or made to service debt obligations relating to a debt security issued, or guaranteed by, the taxpayer, provided however that the debt security is listed or admitted for trading upon a securities exchange licensed by the Capital Markets Development Authority for operation within the Maldives;

(suggested added language underlined)

This will place interest paid on corporate debt on the same tax footing as taking a bank loan. As such it creates “a level playing field”. The language relating to “listed or admitted” is designed to enable the ‘admitted for trading’ concept described below.

II. ENABLING INVESTMENT FUNDS

The Maldives can enable the MIRA to issue regulations providing tax transparency for investment funds, rather than amend the CPT later. I suggest revising CPT Article 102 by adding a subclause (c):

(c) The MIRA shall have the authority to issue regulations governing the taxation of investment funds regulated by the Capital Markets Development Authority, including exemption from taxation under this Act and other Acts related to taxation, under specified conditions.

(suggested added language underlined)

Also the current PIT Bill does not provide for tax equivalency between direct investment and indirect investment. Providing a level playing field between direct and indirect investments should be a tax policy goal for the Maldives.

In order to provide this equal treatment I suggest revising PIT Article 24 governing exempt income.

The following types of income shall be exempt from the charge of tax under this Act.

...

(g) Dividends paid by an investment fund registered with the Capital Markets Development Authority, to the extent that the source income of the investment fund distributed as dividends is derived from one or more of the sources identified in (a) and (b) above, and allocated and identified according to regulations to be adopted by the MIRA.

(suggested added language underlined)

The subclauses (a) and (b) referred to in the suggested language relate to dividends and interest received, respectively.

III. TAXATION OF GENERAL AND LIMITED PARTNERS

Sections 30(4) and 23(3) of the Partnership Act limit the liability of the limited partners to the amount of their fully paid-in capital. The BPT conflicts with this limited liability concept, by making limited partners jointly and severally liable for the tax obligation of the LLP. This is carried over into the CPT at Section 34 which reads:

Partners in a partnership during a taxable period shall be liable individually and collectively to pay tax payable by that partnership in accordance with this Act.

I suggest replacing current CPT Section 34 entirely with the following three subsections:

(a) Every partner in a general partnership who is a partner in that year shall be jointly and severally liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were partners.

(b) Any managing partner of a limited liability partnership shall be liable to pay any tax due and payable under this Act in respect of the profits earned during the period they were managing partners.

(c) Limited partners of a limited liability partnership shall not be liable for the tax obligation of the partnership, except to the extent that payment of the liability results in the dissolution of the partnership and then only to the extent of liability specified in the Partnership Act.

IV. INTRODUCING THE “ADMITTED FOR TRADING” CONCEPT

The main body of this Report discusses the ‘admitted for trading’ concept. To set the foundation within the tax laws, PIT Article 24(a) and (b) should be revised as follows:

24. The following types of income shall be exempt from the charge of tax under this Act.

(a) Dividends paid by an equity security company that is listed or admitted for trading on a securities exchange licensed by the Capital Markets Development Authority for operation within the Maldives Stock Exchange;

(b) Interest paid by debentures that are issued by a company listed or admitted for trading on a securities exchange licensed by the Capital Markets Development Authority for operation within the Maldives Stock Exchange;

(suggested added language underlined; suggested deletions in strikethrough).