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ARGENTINA: MUTUAL FUND REGULATION

by

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Paucity of savings has been recognized as an important constraint limiting the growth and employment opportunities in most Latin American economies. While shortcomings in macroeconomic management are a principal cause, the underdevelopment of financial markets, products, and intermediaries can also raise intermediation costs and deprive savers of appropriate vehicles for savings.

Mutual funds constitute an important savings product and class of financial intermediary. Mutual funds provide small savers opportunities for risk diversification, professional investment management, and access to wholesale transaction costs. They significantly expand the investment opportunities available to small investors who are otherwise restricted to bank products or undiversified stock investments. They can simultaneously offer investors liquidity and foster long term regular saving habit.

While mutual funds are an enormous industry in developed countries, particularly in the U.S.A., they are still an emerging industry in most of Latin America. Only Brazil, Mexico, and Chile have significant mutual fund activity within their borders. The purpose of this series of papers is to make available better information about mutual fund regulation and operations in several Latin American countries, with a view to facilitate a comparison and improvement in their regulation and management.

This paper is part of a series of eight papers. The series is edited by Hemant Shah, Laura Mecagni, and Mike Lubrano, all from Latin America and the Caribbean Region of the World Bank. Papers are written by legal and mutual fund industry experts from Argentina (Steven T. Darch, Bernardo E. Duggan, Leonardo F. Fernández, and Andrew Powell), Brazil (Fernando J. Prado Ferreira), Chile (Santiago Edwards M., Alberto Eguiguren), Colombia (Rodrigo Puyo Vasco), Mexico (Teófilo G. Berdeja Prieto and Agustín Berdeja Prieto), and Peru (Fernando Bellido). Their time and contributions, and the cooperation of their respective institutions, are deeply appreciated.

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ABSTRACT

This paper is part of a series of papers on mutual fund regulations in six Latin American countries: Argentina, Brazil, Chile, Colombia, Mexico, and Peru. It provides an introduction to the regulations and policies governing the three basic structures for collective investment of voluntary savings in Argentina: mutual funds, investment companies, and investment funds organised as trusts. This paper focuses primarily on mutual funds. It briefly reviews the history and the regulatory framework of the industry. It then analyzes the principal aspects of mutual fund structure, shares offered, management companies, and depository companies, etc. and the regulation concerning investment policies, fees, investors’ rights, taxation, and pricing. The paper concludes with brief sections on investment companies and mutual funds organised as trusts.
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ARGENTINA: MUTUAL FUND REGULATION

by

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I. INVESTMENT COMPANIES IN ARGENTINA

In Argentina there are basically three legal structures available for investment vehicles designed to build up the savings contributed by their members, for purposes of profitable and diversified investment in financial assets, particularly, in securities authorised for public offering.

These basic structures are: (i) mutual funds (fondos comunes de inversión); (ii) investment companies (sociedades de inversión); and (iii) mutual funds organised as trusts (fondos de inversión constituidos bajo la forma de un fideicomiso).

a) Mutual Funds

A mutual fund portfolio, which may include the various financial assets provided by law and applicable regulations, is owned by the different persons ("unitholders" or cuotapartistas) investing in the fund who are given joint ownership rights in such assets. The joint ownership rights given to unit holders are represented by securities called "units" (cuotapartes). As such, mutual funds are not companies and are not legal entities under the laws of Argentina. Nor are they trusts, since the ownership of the assets making up the fund is not transferred to a trustee. As indicated above, they are an undivided joint ownership shared by the unit holders.

b) Investment Companies

Investment companies are basically corporations (sociedades anónimas). The legal entity of a corporation is different from that of its shareholders¹. The corporate capital is

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represented by a fixed number of shares (closed-end companies), which may be divided into
different classes of common and preferred stock. Argentine laws do not allow the incorporation
of open-end capital companies. Investment companies formed as corporations are governed by
the Argentine Corporations and Partnerships Act No. 19,550, as amended (the "ACPA").
Accordingly, the peculiarity of these companies is not their legal form, but their corporate
purpose, which consists basically to acquire financial assets and, in particular, shares in other
corporations.

c) Investment Funds Organised as Trusts

While organising investment funds as trusts has been traditional practice in other
countries, this structure has rarely been adopted in Argentina. In our opinion, this is due to the
historical lack of specific regulation on trusts and trust activities in our country. Only very
recently, on January 9, 1995, the National Congress enacted Law No. 24,441 on trusts.

A fund can indeed be organised as a trust. Unlike mutual funds, this type of fund does not
create a joint ownership relationship among its members and, unlike investment companies, it
does not comprise the incorporation of a separate legal entity. In this case, fund assets would be
under the fiduciary control of a trustee, who would be responsible for managing them pursuant to
the management rules and the trust deed creating the fund.

The different ways in which public savings may be invested in financial assets portfolios
in Argentina are not comparable, either in terms of tradition or degree of regulatory detail.
General market acceptance also varies significantly, favouring mutual funds.

As a result, this paper is intended to present the key regulatory aspects of mutual funds.
The other two possibilities are described briefly, due to the lack of extensive regulation on the
subject and since such structures have been hardly used in Argentina.

II. MUTUAL FUNDS

1) DEFINITION, BRIEF HISTORICAL BACKGROUND, AND
REGULATORY FRAMEWORK

Mutual funds have a long tradition in Argentina. These funds provide for a joint
ownership structure, i.e., they do not constitute a separate legal entity but are a form of undivided
joint ownership shared by investors.

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1 Shareholders' liability for losses of an investment company is limited to the value of their respective
shareholdings in the corporation. However, pursuant to the ACPA, as defined below, shareholders who voted in
favor of a resolution that is subsequently declared void by a court as contrary to Argentine laws or the corporation's
By-laws may be held jointly and severally liable for damages to such corporation, other shareholders or third parties
resulting from such resolution.
The first law on mutual funds No. 15,885 was passed in 1961 and was regulated by decree No. 11,146 in 1962. Prior to these statutes, mutual funds providing joint ownership were organised under the undivided joint ownership provisions of the Civil Code. These provisions had some drawbacks, specifically, the time limitation on the undivided nature of the joint ownership. In 1947, Decree No. 15,625 created the (Instituto Mixto de Inversiones Mobiliarias) which was authorized to "receive deposits ... only for accounts participating in securities, debentures and other personal property". This now liquidated governmental agency assured a minimum rate of return and the repayment of the investment.

Currently, mutual funds are governed by the Mutual Funds Act No. 24,083, as amended by the Law No. 24,441, as regulated by decree No. 174 of 1993 (the "MFA"). The MFA did not introduce structural changes with respect to the ownership of fund assets or the legal relationship covering them. However, it provided for certain major changes, as follows:

i) authorisation to create closed-end mutual funds;

ii) extension of investment objectives to include, in addition to listed securities and money, bullion, foreign currency, rights in futures and options, and instruments issued by financial institutions;

iii) flexibility in the treatment given to fund earnings (under the earlier law, regular distributions of earnings to unit holders was a right that could not be revoked, while under the MFA, the treatment of earnings is left to such management rules as each fund may formulate); and

iv) bestowal of mutual fund supervision functions on the Argentine Securities and Exchange Commission (Comisión Nacional de Valores or "CNV").

In addition to the above provisions, the legal framework for mutual funds has been completed by CNV resolutions, notably:

v) General Resolution No. 237 of August 26, 1993, regulating closed-end credit funds and introducing the first provisions relating to securitisation in Argentina;

vi) General Resolution No. 238 of October 7, 1993, regulating the minimum contents of any public offering prospectus for closed-end credit fund units; and

vii) General Resolution No. 240 of December 3, 1993, as amended by General Resolution No. 247 of July 21, 1994, regulating, among other aspects, the authorising procedure for the organisation of mutual funds, including both open-end and closed-end funds.

Pursuant to Section 32 of the MFA, the CNV is responsible for the supervision and registration of companies acting as management companies or depositories for mutual funds.
Notwithstanding such permanent supervision, the MFA has not modified the provisions regarding the incorporation procedures of management and depository companies and, thus, they continue to be under the supervision of the relevant national and provincial agencies (respectively, the Inspección General de Justicia and the Dirección de Personas Jurídicas of the relevant jurisdiction).

2) LEGAL STRUCTURE OF MUTUAL FUNDS

a) Structure of Funds

i) Management Companies and Depository Companies. Pursuant to the MFA, the most relevant features of mutual funds are the following:

- as mentioned, mutual funds are not legal entities but an undivided equity owned by the fund's unit holders; and
- the relationship between the fund and its bodies (the management company and the depository company) is contractual.

As a result of the indivisible nature of mutual funds, a fund cannot be discontinued at the request of unit holders, their successors or creditors. Creditors of the unit holders may only pursue their claims through the seizure and sale of the fund's units, but under no circumstances they can directly seize the assets of the fund.

The MFA sets forth that mutual funds must have two bodies: (i) a management company responsible for managing the portfolio of the fund, and (ii) a depository company responsible for providing custody and safekeeping for the securities owned by a mutual fund and for supervising the performance of the management company.

In addition to the above division of functions, a number of provisions in the MFA contemplate the separation of the two bodies, basically to avoid an eventual conflict of interests. Thus, the main provisions require (i) a sole corporate purpose for management and depository companies which are not financial institutions (in this way, the same company may not act in both capacities); (ii) financial institutions are forbidden to act as the manager and depository for the same mutual fund; (iii) directors, managers, representatives and statutory auditors of the management company are forbidden to act in such a capacity for the depository company; and (iv) the offices of both companies must be physically separate.

However, there are no restrictions on the exercising of control or links between management and depository companies or a controlling company common to both.

(i) Open-end mutual fund. The MFA provides for the organisation of open-end and closed-end mutual funds. Open-end mutual funds continually issue new units which may be redeemed at any moment on holders' demand, except when the fund's management
rules provide specific terms for the exercise of such redemption. The open-end fund's right to restrict redemption must be reasonably regulated through specific provisions contained in the management rules as approved by the CNV.

Subscription and redemption prices are fixed as a function of the fund's net worth, on the basis of the average prices prevailing at the close of business on the day on which unit subscription or redemption is requested.

Redemption must be concluded within three business days after request (except if management rules provide for a longer term) and upon surrender of the appropriate certificate verifying the relevant holding.

However, the MFA authorises to suspend redemptions during periods not provided in the management rules whenever they could be "harmful for any reason". Suspensions longer than three days must be approved by the CNV. Following the MFA regulatory decree, many Argentine funds provide for the suspension of redemptions whenever it is impossible to determine the value of the unit as a consequence of war, local disturbance, stock exchange or banking holidays or any other event having a relevant impact on markets.

The number of units which open-end funds are authorized to issue is not fixed, but varies depending on the number of purchases and redemptions requested. Investment liquidity in this type of fund is given by the obligation to redeem. There is no secondary market and no market value for the units; as indicated earlier, the value market is determined daily on the basis of the fund's net worth.

(ii) Closed-end mutual fund. Closed-end mutual funds, as created by the MFA, have a maximum number of units which, once subscribed, may not be redeemed prior to the dissolution of the fund or the end of the investment plan set out in the management rules.

In this case, investment liquidity is not obtained through the investor's capacity to demand that his holding be redeemed, but through the creation of a secondary market: closed-end mutual funds must, necessarily, be authorized for public offering and quotation in Argentina. Thus, the value of fund units may not be strictly related to the fund's assets and may fluctuate depending on supply and demand.

In August 1993, the CNV passed General Resolution No. 237 which, among other things, regulates "closed-end credit funds" (fondos comunes de inversión cerrados de crédito), one of the forms of closed-end mutual funds. These funds have a specialised portfolio of credits, whether secured (i.e., mortgage portfolios) or unsecured, represented by securities or otherwise, which are transferred for a price to the fund by a financial institution.

Unlike other mutual funds, which are absolutely barred from acquiring securities issued by the management company or the depositary, close-end credit funds can be made up, in whole or in part, of credits originating from the financial institutions acting as the management company or the depositary, or from any other company directly or indirectly controlled by or
affiliated to the management company or the depositary. In such a case, this must be detailed in
the fund's management rules, in the offering memorandum and in any other public
announcement.

Unlike open-end funds, which may be created for an indefinite time, closed-end credit
funds must have a limited duration. Notwithstanding the foregoing, Law No. 24,441 sets forth
that the management rules may provide that, at least one year before the expiration of the fund, a
meeting of unitholders may approve the extension of the duration of the fund. The unitholders'
meeting shall be governed by the rules applicable to shareholders' meetings under the ACPA.
The disagreeing unitholders may withdraw from the fund and receive the value of their units.
Payment must be made within one year of the date of the unitholders' meeting.

In addition, closed-end credit fund units are ruled by the distribution requirements set
forth in the regulations of the CNV and the Buenos Aires Stock Exchange (the "BASE"). They
must also have at least two risk evaluations issued by rating agencies authorized by the CNV and
such ratings must be reviewed on a quarterly basis.

b) Fund Units

Joint ownership rights in the assets making up the fund are represented by securities
called "units" (cuotapartes). Fund units must bear the signature of the representatives of the
fund's management company and depositary company and may be issued as a certificate, in
registered or bearer form, or as book entry units, in which case the depositary will act as the
registrar. The fund's management rules must be transcribed on the units, unless they are issued
in book entry form.

For closed-end funds, CNV regulations provide for the possibility of issuing different
classes of "joint ownership units" (cuotapartes de condominio) depending on the different modes
of principal repayment or interest payments, and with a preference in the distribution of profits or
liquidation of the fund.

Thus, to facilitate placement, the asset originator is permitted to maintain its possession
of ordinary units by selling preferred units in the distribution of profits or liquidation.

In addition, upon enactment of Law No. 24,441 which introduced some amendments to
the MFA, open-end and closed-end funds may issue units called "income units" (cuotapartes de
renta) ensuring repayment of the unit's face value in addition to certain earnings, which will be
conditional to the performance of the assets in the fund. Income units are repayable prior to joint
ownership units, whether common or preferred. The MFA does not prescribe limits to the
issuance of income units.

Income units enable funds to contract debt, and thus the opportunity of creating leveraged
funds is provided in Argentina2.

2 Current Argentine regulations does not provide limitations for issuance of income units.
c) Management Company

i) Functions. As indicated earlier, the functions of a management company are (i) to manage and direct the business and affairs of the fund by implementing such investment policies as the management rules may prescribe (regarding distribution of profits, creation of allowances, acceptance of subscriptions, suspension of redemptions, daily unit pricing, election of placement agent, accounting records) and (ii) to represent unit holders before third parties.

Pursuant to the MFA, the members of the supervisory committee (comisión fiscalizadora) of the management company\(^3\) are responsible for (i) certifying the fund's financial statements; (ii) controlling the status of the investment portfolio; and (iii) giving notice to the CNV of any misconduct on behalf of the management or depositary company.

In closed-end credit funds, the management company is required to prepare a monthly status report of the amount of principal and interest receivable from the credits in the fund's portfolio and all problems related to managing the fund. This report must be submitted to the CNV and any such other self-regulatory institution exchange on which the fund may be listed.

The incorporation of a management company is organised under the relevant national or provincial regulatory authorities, which ever is appropriate; however, after a management company has been organised, it will be under the permanent supervision of the CNV.

ii) Corporate Type. Mutual fund management companies may be either (i) financial institutions or (ii) corporations whose sole corporate purpose is to manage mutual funds, in which case the name of the company should include the words "mutual fund management company".

In the case of item (i) above, the Financial Institutions Law No. 21,526 as amended, authorises only commercial banks, investment banks and financial companies to act as financial institutions. Commercial banks may be structured as corporations or cooperatives, and investment banks and financial companies only as corporations.

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\(^3\) ACPA provides that certain corporations, including the management companies of mutual funds, must appoint a committee of at least three members or syndics (sindicós), referred to as supervisory committee. The primary responsibilities of the supervisory committee are to monitor the management of the company as to its compliance with Argentine law, the By-laws and the shareholders' meetings resolutions, and, without prejudice of the role of the external auditors, to report to the shareholders at the annual ordinary shareholders' meeting regarding the accuracy of the financial information presented to such meeting by the board of directors. Supervisory committee members are also authorized (i) to call ordinary or extraordinary shareholders' meetings, (ii) to place items on the agenda for meetings of shareholders or the board, (iii) to attend meetings of shareholders or the board, and (iv) to generally monitor the affairs of the company.
iii) Minimum Net Worth. Pursuant to the MFA, companies acting as mutual fund managers should have a minimum net worth equal to 50,000 pesos and such sum must in no event be lower than U.S.$50,000. If any one management company should manage more than one fund, then such company's minimum net worth must increase by twenty five percent per each additional fund managed.

iv) Investment Advisors. Notwithstanding the legal responsibilities imposed on management companies, some Argentine closed-end funds (specialised in investments in securities traded outside of Argentina), do retain investment advising services. The opinion given by such consultants does not bind the management company.

d) Deposit of Fund Assets

i) Functions. Pursuant to the division of functions provided by the MFA, the depositary is responsible for the deposit and custody of the assets in the fund's portfolio and for controlling and supervising the performance of the statutory rules and regulations by the management company.

In addition, the depositary is required:

- to receive the amounts payable for the units issued and, for open-end mutual funds, to pay for redemptions;
- at the expiration of the fund's duration, to make any such payment as each unit may have a right to;
- to collect such income as fund assets may generate;
- to keep a register of units and to issue evidence of ownership of book entry units, if so requested by unit holders; and
- to enter into subscription agreements with unit holders.

Regarding specialised real estate funds, pursuant to Law No. 24,441 the depositary company is also responsible for:

- acting as trustee for the benefit of the unitholders in connection with real properties and mortgage credits; and
- the management of real properties, in accordance with instructions issued by the management company, although the management rules could set forth that the management company shall directly fulfil such functions.
ii) Corporate type. Like management companies, depositories may be financial institutions or corporations whose sole corporate purpose is to act as a mutual fund depositary company, in which case the name of the company must be accompanied by the words "mutual fund depositary company".

iii) Minimum net worth. The MFA states that companies acting as mutual fund depositories must have a minimum net worth equal to 100,000 pesos and such sum must, at all times, be equivalent to U.S.$100,000.

iv) Custodian outside Argentina. Funds whose portfolios include a relevant portion of securities traded abroad may retain a custodian of the assets outside Argentina.

e) Liability of the Management Company, Depositary and Members of their Management and Supervisory Bodies

Pursuant to the MFA, the management company and the depositary, its administrators, managers and members of the supervisory bodies are jointly and severally liable, without limitation, for any damages to unit holders resulting from their failure to meet the applicable laws and the fund’s management rules.

The reason underlying the responsibility of the management company and the depositary is objective. Thus, having proved that there is a relationship between the damage and the non-compliance, unit holders will have the right to be indemnified, notwithstanding any reimbursement demand between the management company and the depositary, and these companies will not have the right to allege due diligence as their defence.

Conversely, the responsibility of the members of the management and supervisory bodies is personal and based on negligence or intentional non-performance of their obligations. Under ACPA, directors have the obligation to perform their duties with the loyalty and the diligence of a "prudent business man".

The above notwithstanding, the unitholders have no rights to change the management or depositary companies of the fund or the members of the board of any such companies.

f) Structuring the Management Rules

Unlike investment vehicles structured on a statutory or trust basis, mutual funds organised under the MFA are based on an agreement between the management company and the depositary called the management rules (reglamento de gestión). Investors purchasing units are

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4 The above notwithstanding, the party in fact responsible regarding the unitholders, may claim the relevant indemnification or contribution, as the case may be, against the other indemnifying parties.
bound by the management rules. Generally, the management rules regulate the organisation, operation and liquidation of the fund.

Once the management company and the depositary are incorporated, the management rules are agreed to by both companies, subject to the approval of their respective board of directors. The management rules may take the form of either a public deed or a private instrument sworn before a notary public or the CNV.

The management rules are then filed for CNV approval together with any other documentation required by the CNV in accordance with CNV Rules. Pursuant to the MFA, the CNV must present an opinion regarding the approval of the management rules within thirty days of filing, including all the other documentation required by CNV Rules. If the CNV should fail to present an opinion within the above period, the management rules will be considered to be approved.

Upon CNV approval, the management rules must be published for two days in the Official Gazette of Argentina and in a leading newspaper having general circulation in the jurisdictions of the management company and the depositary. The management rules are then filed with the Public Registry of Commerce (Registro Público de Comercio).

Each investor must be given a copy of the management rules at the time of subscription, but this may be substituted by a transcription of the management rules on the unit certificates.

Minimum mandatory scope. The MFA and the CNV Rules provide for the minimum scope to be covered by the management rules, as follows: (i) organisation, changes and liquidation of the fund; (ii) operation of the fund; and (iii) settlement of disputes between the management company and the depositary.

i) Organisation, Changes And Liquidation of the Fund:

- terms and procedures for subscription and, for open-end funds, terms and procedures for unit redemption and calculation of unit value;

- determination of ceilings for subscription and redemption commissions or charges;

- duration of the fund or, for open-end funds, evidence of no time limitations. If a fund is established for an indefinite time, it could be agreed that the management company or the depositary may request the fund's dissolution for reasonable cause, and such a request will be effective after approval by the CNV.
• causes for liquidation, liquidation rules and the basis for asset
distribution to unit holders;

• provisions for amending the management rules. For closed-end
funds, the management rules cannot be amended until the
investment plan has been complied with, except for the
amendments affecting minor clauses of the plan in favour of
unit holders, in which case a provision granting unsatisfied unit
holders appraisal rights must be included rules applicable to the
distribution of earnings to unit holders;

• for closed-end funds, the management rules must provide for
investment liquidity in case of interruption of unit quotation.

ii) Operation of the Fund:

• investment plans for the fund's portfolio, specifying the targets
and limitations according to each type of asset, and
management limitations on fund assets, if any;

• minimum investment diversification guidelines for the fund's
portfolio, including a ban on mutual funds, other than closed-
end credit funds, forbidding their management from
committing more than twenty percent of their assets to
securities from a single issuer or several issuers belonging to
the same group\(^5\);

• limitations on management expenses, commissions and fees
payable to the management company and the depositary, in the
form of an annual percentage in every respect, a twelfth of
which will be charged to the fund at the end of each month;

• conditions for exercising the voting right in the shares making
up the fund's portfolio;

• closing date of the fiscal year;

• if included as a corporate purpose of the fund, a list of the
foreign markets in which investments may be made and, for

\(^5\) As explained above under caption 2 (a), (ii), in order to favour securitization transactions, the CNV
regulations provide that closed-end credit funds can be made up, in whole or in part, of credits originating from the
financial institutions acting as the management company or the depositary, or from any other company directly or
indirectly controlled by or affiliated to the management company or the depositary.
unit value calculation purposes, how to get the current price in such markets in an adequate time frame.

iii) Settlement of Disputes

- description of the procedures leading to a prompt solution of any disagreement arising between the fund’s bodies. Some funds in Argentina provide for referral to a court of arbitration, whose decision must be ratified by the CNV.

Optional clauses. In addition to the above mandatory provisions, the management rules may include clauses relating to the transfer or exchange of units, replacement of lost or stolen units, conditions for entering into agreements with dealers for purposes of optimising unit distribution to the public, creation of reserves or allowances, use by the fund of dividends made available but not collected.

Amendment to the management rules. As indicated earlier, one of the mandatory clauses refers to the ways in which the management rules can be amended. These ways may be either: (i) a procedure providing for some kind of consultation with unit holders; or (ii) a direct amendment introduced by the management company and the depositary, in which case the general consent of the unit holders is deemed to have been given prior to the introduction of the amendment at the time of subscribing the unit. Most funds organised in Argentina favour this approach.

Amendments may affect administrative aspects, such as setting the dates of the fund’s fiscal year, distribution of earnings, subscription and redemption procedures or issues relating to investment, fee and spending policies.

Any type of amendment, whether approved upon consultation with unit holders or by mere agreement of the management company and the depositary, requires the approval of the board of directors of the management company and the depositary and the prior approval of the CNV, to whom a request for such an amendment must be presented.

Upon CNV approval, to be given within thirty days of the application for amendment, the amendment must be published in the Official Gazette of Argentina and in a leading newspaper having general circulation in the jurisdictions of the management company and the depositary. The management rules are then filed with the Public Registry of Commerce.

g) Structure of the Board of Directors of the Management Company and the Depositary

As indicated above, the MFA and regulations thereunder contain certain provisions intended to ensure the reciprocal independence of the management and depositary companies.
To that end, the MFA forbids directors, managers, representatives and members of the supervisory committee of the management company to serve as a director or supervisory committee member for the depositary.

h) Distribution of Units to Investors

Soliciting efforts, whether for open-end or closed-end funds, may be carried out directly by the depositary or be entrusted to dealers authorized to act as soliciting agents by the CNV. In the latter case, a dealer agreement (based on best efforts or a firm commitment) must be made by and between the management company and each dealer. Any dealer agreements must be reported to the CNV.

3) REGULATION OF THE INDUSTRY

a) Investment Policies

i) Assets eligible for investment. Unlike the former system for mutual funds, the MFA provides for a comprehensive investment purpose, whereby funds may invest in the following assets: (a) listed securities; (b) bullion; (c) foreign currency; (d) rights and obligations in futures or options transactions (including, without other limitations than those specified under (ii) below, derivative instruments); (e) instruments issued by financial institutions authorized by the Central Bank of Argentina; and (f) national currency.

In addition to said assets, Law No. 24,441 sets forth that closed-end funds may invest in homogeneous or similar sets of real or personal property or credits, in accordance with the regulations to be issued by the CNV.

Securities and rights and obligations in futures and options transactions must be authorized for listing in Argentina or abroad, and at least 75% of the investment must consist of securities issued and traded in Argentina. However, for purposes of meeting the above limitation, securities issued by companies in countries holding capital markets integration agreements with Argentina or with the CNV, will be considered to be securities issued in Argentina, always provided that such securities are negotiated in the country of the issuers on markets approved by the respective securities and exchange commission or equivalent authorities.

Accordingly, pursuant to CNV General Resolution No. 242 of February 1994, for purposes of calculating the above limitation, securities from Brazilian, Paraguayan and Uruguayan issuers are deemed to be issued in Argentina to the extent that they are traded on the markets of those countries. At least two closed-end funds have been organised under this Resolution for the specific purpose of investing in securities issued, inter alia, by companies in the above countries.

Funds are not allowed to invest in securities other than listed securities nor in units issued by other closed-end or open-end mutual funds.
ii) Minimum investment diversification guidelines for a fund's portfolio. For an adequate risk spread, rapid portfolio appraisal and addressing conflicts of interests, the MFA contemplates minimum investment diversification guidelines to be followed by management. These guidelines are:

Diversification regarding security issuers:

- share holding may not exceed ten per cent of the capital stock of the issuer;

- debt-security holding may not exceed ten per cent of the total liabilities of the issuer pursuant to the latest known annual or intermediate financial statements.

- The above percentages must be observed simultaneously; a smaller percentage in either item does not authorise a surplus in the other.

Diversification regarding fund assets:

- the fund may not invest more than twelve per cent of its assets in securities from a single issuer or issuers belonging to the same economic group, except in the case of public debt titles issued under the same conditions, where the limit set is thirty per cent of the fund's assets.

Any excess in the above ceilings must be reported to the CNV and disposed of forthwith, without limiting any legal responsibility arising from such violations of the limitations. Any excess resulting from the exercise of pre-emptive or conversion rights is not an infringement, but such excess must be disposed of within six months.

iii) Conflict of Interest

- the fund may not hold securities issued by the management company or the depositary;

- the fund may hold only two per cent of the equity or debt of the holding company of the management company or the depositary pursuant to the latest annual or intermediate financial statement issued by that company. In this case, the fund may not exercise the voting rights in the shares held.

iv) Voting Rights. The fund may not exercise more than five per cent of the voting rights granted by a single issuer, whatever its holding.
v) Liquidity. The MFA establishes no minimum cash ratio.

In order to avoid impairing the fund’s corporate purpose as a result of high cash ratio requirements, CNV Rules provide that such ratios may not be higher than ten per cent of the fund’s assets. In exceptional cases, the above percentage can be exceeded if it responds to management requirements for the fund’s portfolio, as set out in the management rules and for a period not to exceed 180 calendar days; notice of such excess must be given to the CNV.

vi) Consistency between name and portfolio structure. Specialised funds. For specialised mutual funds or funds including in their name a given asset category (e.g. shares, fixed income securities, floating income securities, real properties), CNV Rules provide that at least eighty per cent of such fund’s assets must be invested either in assets representing the specialised investment purpose or any such assets as may be referred to in the name of the fund.

vii) Leveraged Mutual Funds. Prior to the amendments introduced by Law No. 24,441 to the MFA, mutual funds could not contract debts because they are not legal entities, they could only invest their own equity, that is, the contributions made by investors. This limitation precluded the creation of the so called leveraged funds, that is, funds that can provide an additional benefit for unit holders by investing the funds raised from loans given out at a fixed interest rate which is lower than the expected rate of return for the investment. However, as outlined above, since the enactment of Law No. 24,441 and the applicable CNV Rules, mutual funds may issue income units, thus enabling the fund to incur in some sort of debt, although repayment is subject to the profits earned by the fund.

b) Ceiling on Fund Management Expenses, Fees and Commissions Chargeable to the Fund or to the Unit Holders

As indicated in the summary of the minimum mandatory provisions to be included in the management rules, such provisions must set out the limitations on (i) fund management expenses and (ii) fees and commissions payable to the management company and the depositary. The management rules must determine a maximum annual percentage payable in every respect, the twelfth of which will be charged to the fund each month. Expenses, fees and commissions may not exceed such ceiling, other than taxes imposed on fund asset transactions.

Neither the MFA nor the regulations issued thereunder prescribe limits to the fees and commissions payable to the management company or the depositary.

Usually, there are two types of fees payable to management companies and depositaries, namely, (i) a general fee in consideration of their respective designated tasks; and (ii) a success fee, which is added to the general fee and becomes payable only if the fund has earned a profit in

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6 As explained above, the management rules must include limitations on fees and commissions payable to the management and depositary companies, however, as also explained, the management rules may be amended.
excess of a certain percentage of the fund's portfolio relative to the prior fiscal year, in accordance with the management rules.

In addition to the charges payable by the fund, the management rules may also fix ceilings for commissions and charges payable by unit holders in respect of unit subscription, redemption, certificate exchange and issue of duplicates.

c) Investor Protection

i) Front-running, self-dealing and insider trading. The MFA and regulations thereunder have no specific provision prohibiting or restricting front-running or self-dealing situations. However, the legal relationship between the management company and the fund is that of principal-agent and is governed by the principles applicable to such a relationship. The management company may not jeopardise either its own interests or those of the fund it manages and, in the event of conflict of interests, the interests of the fund will have priority over the interests of the management company.

The CNV has passed General Resolution No. 190, as amended by General Resolution No. 227, regarding insider trading. Under such Resolution, the management company and the depositary and their directors, managers, key employees, auditors and advisers are prohibited from capitalising on inside information.

ii) Minimum net worth requirements. Management companies and depositories are required to maintain the minimum net worth set out above.

iii) Publication requirements. In addition to the publication requirements relating to the organisation of the fund outlined above, the MFA sets out the frequency and minimum publication requirements regarding the fund's performance. Thus, the management company must publish:

- value and number of issued units, net of subscriptions and redemptions, on a daily basis;
- investment portfolio structure, on a monthly basis;
- statement of income, on a quarterly basis; and
- balance sheet, statement of income and detail of assets making up the fund, on an annual basis.

At the time of organising the fund, the management company and the depositary must determine where the above will be published. They can chose the gazette of any stock exchange or market or a leading newspaper having widespread circulation in the jurisdictions of the management company and the depositary.
All promotional advertising of the fund is under the control of the CNV and must be brought to its knowledge within three days of publication. In the event of unit distribution by dealers, any advertising made by dealers will be subject to the approval of the management company.

iv) Prospectus. CNV General Resolution No. 238 provides for the minimum scope requirements for any prospectus only for closed-end fund units under MFA and CNV General Resolution No. 237.

Prospectus must contain: (a) a description of the management company and the depositary (corporate data, other funds for which they act as management company and depositary, directors and supervisory committee members, legal-economic relations); (b) a description of the units (classes, rights, income, guarantees); (c) risk rating7; (d) equity structure; (e) stock exchanges and markets on which the units will be listed; (f) fees; (g) commissions and charges; (h) dealers; and (i) transcription of the management rules.

d) Taxation

Pursuant to the MFA and the regulations thereunder, mutual funds, whether open-end or closed-end, are not legal entities and are not liable for taxes. The only taxable persons in respect of any tax payable on unit earnings, or on the distribution of fund earnings, or on earnings from the sale of units, are the unit holders.

Neither the management company nor the depositary are obligated to act as withholding agents and are not liable for any tax default incurred by unit holders.

e) Tax Treatment for Investors

i) Taxation Of Dividends. Dividends of the mutual funds paid to holders individuals residing in Argentina and foreign beneficiaries, whether individual or companies, are tax exempt from Argentine withholding tax. Dividends paid to unitholders that are taxpayers subject to the tax adjustment for inflation rules of the Argentine income tax law (in general, entities organised or incorporated under Argentine law, Argentine branches of foreign entities, and Argentine sole proprietorships) are subject to withholding tax at a general rate of thirty per cent.

ii) Taxation of Capital Gains. Individuals residing in Argentina and foreign beneficiaries, whether individual or companies, are tax exempt in respect of earnings on

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7 Presidential Decree No. 656 issued on April 23, 1992, requires all debt securities to be rated by two authorized Argentine rating agencies prior to be authorized for public offering in Argentina. Regulation No. 273 of the CNV extended the same requirement to closed-end fund units. Prior to the above mentioned Decree, there were no rating agencies in Argentina. The Decree, together with CNV Resolution No. 221 issued on October 21st, 1992, established certain general rules in relation to such ratings. Specific guidelines for the standards to be applied in establishing ratings are submitted by prospective rating agencies to, and approved by, the CNV.
the sale or other disposal of units issued by funds organised under the laws of Argentina.
Unitholders that are taxpayers subject to the tax adjustment for inflation rules of the Argentine income tax law (in general, entities organised or incorporated under Argentine law, Argentine branches of foreign entities, and Argentine sole proprietorships) are liable for capital gains arising from the sale or other disposal of units at a general rate of thirty per cent.

   iii) Tax on Personal Assets. This tax does not apply to investments in fund units.

   iv) Tax on Assets. This tax has been repealed for assets listed in financial statements ending June 30, 1995 onwards and does not apply to investments in fund units.

   v) Stamp Tax. Executive decree No. 114/1993 repealed this tax in federal jurisdiction (City of Buenos Aires).

   vi) Securities Transfer Tax. This tax has been repealed by decree No. 2,284 as ratified by Law No. 24,307 of 1993.

   f) Distribution of Income of the Fund

   Unlike the former system, the MFA does not provide for mandatory parameters for the periodic distribution of fund earnings, but the fund's dividend policy must be detailed in the management rules.

   g) Price Quotations and Method of Calculations

   As indicated above, subscription and redemption prices for open-end funds are set on the basis of the fund's net worth, according to the following guidelines:

   for government securities and corporate bonds, the market value prevailing at 3 p.m. on the date on which the redemption or subscription is requested in the over the counter automated open market (Mercado Abierto Electrónico S.A. or the "MAE");

   • for shares, the market value prevailing at 3 p.m. on the date of placing the request for such redemption or subscription with the BASE (ordinary trading session);

   • for fixed income securities not traded during that trading day, the value as of their last trading day;

   • for securities quoted outside Argentina, the closing price nearest to the time of appraising the holding being sold;
• for instruments issued by financial institutions and not included in the above, their original value plus any interest earned thereon as of the date of appraisal;

• for bullion, the management rules must provide for applicable appraisal parameters, duly approved by the CNV;

• for foreign currency, appraisal is made according to the buying price offered by Banco de la Nación Argentina for financial transactions; and

• for rights in futures and options, the average closing price in the stock market on which such kind of rights are most actively traded, on the date on which the redemption or subscription is requested.

If subscription or redemption is requested on a day when the assets making up the fund are not traded, assessment of the fund's net worth shall be based on the average weighted price prevailing on the date on which trading resumes.

However, in case the portfolio includes securities and one or more bonds which are not traded, the values to be considered are those of the last day on which trading took place; except for fixed income securities, where the original value plus interest earned thereon shall be taken into account.

III. INVESTMENT COMPANIES

As anticipated, while mutual funds are indeed the main investment vehicles in Argentina, they are by no means the only ones. In fact, it is quite possible to organise joint-stock companies or corporations for the purpose of acquiring equity interests in other companies.

Holding companies, whose purpose is to have control over the companies in which they have an interest, are beyond the scope of this paper. Investment companies, in the strict sense of the term, are not intended to control the companies in which they have an interest, but to obtain attractive earnings and equity appreciation by selecting and diversifying investments.

1) REGULATORY FRAMEWORK

Investment companies are not specifically regulated by the laws of Argentina, therefore, the provisions on corporations (sociedades anónimas) are applicable to them, with the exception outlined later in this section.

All commercial companies in Argentina, including investment companies, are closed-end companies, that is, with a limited number of shares outstanding. This means that (i) investment
liquidity for this type of company is provided by a secondary market created on the basis of the stock exchange quotation of the company's shares; and (ii) the value of such shares is a market value subject to supply and demand forces and, as a result, such value may or may not coincide with the equity value of the shares.

Floating capital companies may not be organised under Argentina's current regulatory framework. Therefore, the only legal form that the so-called open-end funds can take is that of a joint ownership with the structure described for open-end mutual funds.

2) PORTFOLIO STRUCTURE AND MANAGEMENT

Under Section 31 of ACPA, commercial companies are prohibited from having an interest in one or more companies in excess of their free reserves and half their capital and legal reserve. However, this prohibition applies neither to companies whose sole object is a financial or investment purpose, nor to financial institutions authorized by the Central Bank of Argentina.

The regulatory framework applicable to the government, management and internal supervision of the affairs of investment companies is the same as for corporations. Their by-laws may fix the basic guidelines for financial assets eligible for investment, while governing functions are performed by the company in ordinary or extraordinary meetings of shareholders, depending on the business transacted.

A board of directors manages the investment portfolio of the company. Notwithstanding the functions and responsibilities given to the board by the ACPA and the fact that in principle such functions are inalienable, the company could enter into temporary or permanent management or financial advisory agreements with specialised companies (financial advisers). There are no statutory or regulatory limitations on the fees payable under these agreements, but according to CNV and BASE standards, the terms of these agreements must be reported to either the CNV or the BASE or both and, unless an exception is obtained from the CNV, they must be published in the BASE Gazette. In all cases, an adequate description of the highlights of these agreements must be included in any prospectus or offering circular prepared by prospective issuers.

The internal surveillance body of investment companies organised as corporations may be a supervisory committee formed by accountants or lawyers, who may or may not be shareholders, or an overseeing council, consisting solely of shareholders.

Pursuant to the ACPA and CNV Rules the maximum amount payable to directors for every respect may not be higher than twenty-five percent of corporate earnings. Such an amount may drop to five percent whenever dividends are not distributed to the shareholders and will increase in proportion to the distribution of earnings up to the twenty-five percent limit if distributable earnings are distributed in full.

The above notwithstanding, if one or more directors should hold a special office or perform technical administrative duties, or if small or non-existent profits should require that the
above limits are exceeded, these limits may be exceeded subject to the prior consent of the meeting of shareholders.

3) LEVERAGED FUNDS

A comparative advantage of investment companies over mutual funds is that, pursuant to the principles governing mutual funds and with the exception of mutual fund issuing income units, mutual funds may not contract debt. While this precludes mutual funds from creating leveraged funds, such is not the case for investment companies.

There are only a few investment companies in Argentina and they are listed on the BASE. However, none of them is purely an investment company since they hold controlling equity interests in other companies.

IV. MUTUAL FUNDS ORGANIZED AS TRUSTS

This vehicle has yet to be used in our market. Under this arrangement, the fiduciary ownership of fund assets is transferred to a trustee who is required to manage these assets for the benefit of unit holders in pursuance of the guidelines set forth in the trust deed organising the fund. Unlike mutual funds, no joint ownership relationship is created among unit holders and, unlike investment companies, the creation of a new legal entity is not required. This arrangement may be employed in parallel with closed-end credit funds for securitisation purposes.

Even if this alternative is not fully regulated by the laws of Argentina, it could be developed on the basis of certain provisions, notably, Law No. 24,441 (Trust Law), Section 2,662 of the Civil Code, as amended by Law No. 24,441 defining fiduciary ownership and decree No. 2,088/1993 regulating asset registration in favour of a trustee.
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