



**USAID**  
FROM THE AMERICAN PEOPLE

# MUTUAL FUNDS

Supplemental Issues Regarding the Proposed Mutual Funds  
Instructions

May 13, 2007

This publication was produced for review by the United States Agency for  
International Development. It was prepared by Tabbaa & Partners Law Firm

# MUTUAL FUNDS

## SUPPLEMENTAL ISSUES REGARDING THE PROPOSED MUTUAL FUNDS INSTRUCTIONS

SUSTAINABLE ACHIEVEMENT OF BUSINESS EXPANSION AND  
QUALITY (SABEQ)

CONTRACT NUMBER: 278-C-00-06-00332-00

BEARINGPOINT, INC.

USAID/JORDAN ECONOMIC OPPORTUNITIES OFFICE (EO)

MARCH 13, 2007

AUTHOR: TABBAA & PARTNERS LAW FIRM

1.6.2.1 PROVIDE LEGAL ASSESSMENT OF DRAFT MUTUAL  
FUNDS INSTRUCTIONS AND UPDATE INSTRUCTIONS TO  
REFLECT FINDINGS

### DISCLAIMER:

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

# CONTENTS

<b>EXECUTIVE SUMMARY</b> .....	<b>1</b>
<b>SUPPLEMENTAL ISSUE (1)</b> .....	<b>3</b>
Creation and Establishment of Mutual Funds as a Legal Person under the Securities Law	
<b>SUPPLEMENTAL ISSUE (2)</b> .....	<b>6</b>
Jurisdictional issues with companies authorized by the Companies General Controller and the Companies Supervision Directorate associated with the Ministry of Industry & Trade	
<b>SUPPLEMENTAL ISSUE (3)</b> .....	<b>8</b>
Interaction with other laws, regulations and regulatory authorities in Jordan	
<b>SUPPLEMENTAL ISSUE (4)</b> .....	<b>12</b>
Liability of the mutual fund entity, its management, and other service providers to third parties	
<b>SUPPLEMENTAL ISSUE (5)</b> .....	<b>13</b>
Corporate governance of the mutual fund entity	

## EXECUTIVE SUMMARY

Tabbaa and Partners were commissioned by the SABEQ Program “to review and assess the compatibility of the existing draft Mutual Fund Instructions with applicable laws in Jordan, and to address remaining legal issues so that the instructions can be adopted by the Jordan Securities Commission (the “Commission” or the “JSC”) and licenses to mutual funds can be granted.” In response to this request, Tabbaa and Partners met with the Securities Commission to discuss the necessary steps for the completion of this task and agreed to address the remaining legal issues referred to as the “Supplemental Issues” and resolve any pending legal question prior to tackling the instructions.

Prior to addressing each of these issues, a judgment as to whether the current Securities Law allows for the creation of Mutual Funds in the corporate form, and whether it enables the Commission to issue the necessary instructions for the regulation of such Mutual Funds, must be made.

According to Article (94) of the Securities Law, there are two forms of mutual funds allowed in Jordan; Investment Companies, which are established pursuant to Article (209) of the Companies Law, and Mutual Funds entities, which are established pursuant to Article (91) of the Securities Law. The first form of a Mutual Fund clearly follows the Corporate Model, as it requires the establishment of a duly incorporated Public Limited Company, and adhering to the various rules of Companies Law regulating the corporate governance of such companies. A close examination of the provisions of the Securities Law governing Mutual Funds entities confirm that such entities follow the corporate model as well, considering that such entities are administered by a board of directors must have a memorandum of association, which is similar to the requirements of incorporation under the Companies Law. As for the authority of the Commission to issue such instructions, the law explicitly grants it such mandate by virtue of the provisions of Article (91) thereof.

This Report addresses the legal issues raised by NASD in order to ensure that the Commission is acting within its authority to regulate the affairs and activities of the Mutual Funds and Investment Companies. The Report reflects the methodology followed in addressing these issues; such methodology begins with identifying the pertinent legislation, followed with a thorough analysis of such legislation and the underlying legal rules, and concludes with a legal judgment and recommendations.

The following is a summary of the main conclusions made under this Report:

- According to Article (94) of the Securities Law, there are two forms of mutual funds in Jordan; Investment Companies, which are established pursuant to Article (209) of the Companies Law, and Mutual Funds entities, which are established pursuant to Article (91) of the Securities Law;
- The Commission has an exclusive authority to establish and regulate Mutual Funds entities on the one hand, and to regulate the business operation of the Investment Companies within the meaning of Article (94) of the Securities Law and Article (209) of the Companies Law;

- The Controller's role, with respect to such Investment Companies is confined to their corporate structure and governance, as the Companies Law explicitly refers the business operation of such companies to the Securities Law;
- The rights and obligations arising out of contractual dealings of Mutual Funds relating to financial transactions in securities are exclusively governed by the Securities Law, whereas, their other contractual relations are typically governed by the general rules of contract law;
- Mutual Funds are considered as legal persons and are subject to tax obligations, as prescribed in the respective applicable laws;
- While securities are explicitly excluded from the Commercial Code, the merchant status is extended to the mutual fund as a legal entity engaging in commercial activities;
- Mutual Fund entities are distinctive legal personalities, acknowledged by Law, and are subject to their own corporate governance rules, which may be different from those governing companies.

## **1. Creation and establishment of the mutual fund as a legal person under the Securities Law**

---

Jordan has been following a progressive governmental model that draws on the establishment of autonomous public institutions known as the “regulatory commissions”. These commissions are semi-government specialized bodies, which assume the role of the government in rendering public services and functions; although not a new model, it has become more popular in the past few years as an alternative delivery structure that operates outside the conservative and sometimes modest performance of the central government.

The Jordan Securities Commission (the “Commission” or the “JSC”) was established as one of these public institutions, with a specific mandate to protect investors in securities; the JSC is entrusted with developing and regulating the capital market to ensure fairness, efficiency, transparency, and protection against potential risks.

According to Article (94) of the Securities Law, there are two forms of mutual funds in Jordan; Investment Companies “ICs”, which are established pursuant to Article (209) of the Companies Law, and Mutual Funds “MFs” entities, which are established pursuant to Article (91) of the Securities Law. The Commission is charged with the regulation of essentially all aspects of the “MFs” and the business operation of the “ICs”, including the following:

1. Determining the rights and obligations arising from any securities including shares and investment units of MFs, pursuant to Articles (3) and (6) of the Securities Law;
2. Regulating all Dealings with investment units or stocks issued by MFs,<sup>1</sup> pursuant to Article (6) of the Securities Law; and
3. Managing the activities of MFs and ICs, pursuant to Article (8) of the Securities Law.

The Commission also has the authority to process and approve applications for the registration and establishment of MFs, under Article (12) of the Securities Law, and to issue all necessary approvals thereto, as prescribed in Articles (91-95) of the Law. Moreover, the Commission is responsible for monitoring and supervising the activities of MFs and ICs, pursuant to Article (15) of the Law.

Following the logic of the regulatory model explained above, it is apparent that the Commission is granted such authorities on exclusive basis, by virtue of a special law, which vests with the Commission regulatory powers independent from any ministry or any other public agency. However, it is prudent to review all relevant laws and court rulings to further establish such exclusivity.

---

<sup>1</sup> Article (2) explains that Dealing includes registration, issuance, subscription, promotion, marketing, custody, listing, depositing, trading, settlement, purchase from Issuer, public offer or public takeover bid of securities or the financing of dealings in securities, or the lending, borrowing, short sale or hypothecation of securities

At first instance, the review of other laws suggests potential overlap between the authorities of the JSC and the Companies Control Department (the “Controller” or the “CCD”) at the Ministry of Industry and Trade; the Controller is granted the authority to register any company in Jordan in accordance with the provisions of the Companies Law, which appears to be similar to the authorities of the JSC to approve the registration and establishment of the MF entity on the one hand, and its authority to regulate and supervise the ICs, on the other.

Based on a further analysis, it became evident that such functions, while appear similar, are in fact distinctive and thus, there is no factual overlap between the roles of the two agencies, considering the following:

- While ICs are registered with the Controller as public shareholding companies “PLC’s”, and therefore are subject to the requirements for establishing such companies under the Companies Law, the monitoring and supervision over the operation of these companies remains with the Commission. Close examples to this are banks and insurance companies, as both must be registered as PLC’s at the CDD and are regulated by the Central Bank and the Insurance Regulatory Commission, respectively.

Close examination of both laws supports the view that these agencies, each has a distinct function; the Controller is concerned with the corporate governance of the ICs as relates to internal management and structure, whereas, the Commission is concerned with matters related to the business operation thereof. To clarify, “management” of a company extends to matters such as the structure of the board of directors, competency of the ordinary and extra extraordinary general assembly, appointment of auditors and employee affairs, while the “operation” of an IC extends to the relationship with investors, registration of its securities, accreditation to provide financial services and monitoring the performance thereof.

As such, the Controller is only concerned with ICs in so far as its corporate structure; it does not deal with ICs with respect to their business operation or management of activities, so long as the requirements of corporate governance are met. This conclusion is further emphasized by Articles (7) & (209) of the Companies Law, which explicitly refer the operation of such companies to the Securities Law.

- As for MFs, these entities are established, regulated and monitored by the Commission without any deference to the Companies Law or the Controller; notwithstanding their corporate structure, these entities derive their legal personality from the Securities Law and are entirely established, governed and dissolved according to its provisions.

Under Jordanian Law, legal entities are recognized and are governed by their respective special laws that create them;<sup>2</sup> while exclusive jurisdiction over such legal entities is not explicitly granted to their laws, the Court of Cassation has ruled on several occasions

---

<sup>2</sup> Article (52) of the Civil Code states that juridical entities are subject to the laws establishing them; several court rulings have concurred the same understanding.

that such special laws override any conflicting legislation.<sup>3</sup> Such superiority also extends to any complimentary legislation, including regulations and/or instructions issued pursuant to the provisions of any special law.<sup>4</sup>

Consequently, and considering that MFs are established under the Securities Law, they are entirely governed by its provisions, particularly, Articles (91)-(106). The intention of the legislator to exclusively regulate MFs under the Securities Law can be deduced from the fact that these provisions regulate the establishment of the MF, its management and operation and all other aspects thereof, as opposed to ICs, where such matters are not addressed by the Securities Law. Moreover, Article (12) which explicitly grants the Commission the authority to approve the establishment of MFs does not contain any reference to the ICs. Apparently, the legislator intended to leave the incorporation of an IC to the general requirements of the Companies Law, particularly Article (209), while it reserved all matters pertaining to the MFs within the jurisdiction of the Securities Law.

Based on the above analysis, the Commission enjoys an exclusive and undisputed jurisdiction over MFs; the Controller or any other government body, does not have any authority over such entities, in spite of their corporate structure. The MFs are recognized legal entities deriving their legal personality from the Securities Law, which governs all aspects thereof, from inception to dissolution.

As for ICs, while the authorities of the Commission appear to overlap with those of the Controller, the Controller is only concerned with such ICs in terms of their corporate governance as PLC's, considering that the Companies Law explicitly defers all matters related to their business operation to the Securities Law.

---

<sup>3</sup> The Court of Cassation explained that the special law will be considered an exception of the general law if it was passed before it, and a restriction thereto if was issued after it. In all cases the special law supersedes the general law. Ruling No.7/1979 issued in 12/3/1979.

<sup>4</sup> The Court of Cassation ruled, with regards to notice requirements, that when there is a special provision of the Income Tax Law and the Income Tax Regulation, there is no point of going back to the general requirements mentioned in Law for Civil Proceedings unless there was no provision in the special law. Ruling No. 208/1964, issued in 5/8/1964.



## **2. Jurisdictional issues with companies authorized by the Companies General Controller and the Companies Supervision Directorate associated with the Ministry of Industry and Trade**

---

The analysis of this issue closely follows the analysis of the first issue above; the legal entity of an MF is governed and regulated by the Securities Law, which establishes it.

Pursuant to Article (6) of the Securities Law, the JSC is explicitly charged with the regulation of the following:

- i. The rights of the parties arising out of the sale, purchase or transfer of securities;
- ii. The method and specific form of registration of ownership rights and the legal effects thereof;
- iii. The transfer of ownership rights and the rights arising from such transfer;
- iv. The rights of the parties involved in the clearing, settlement and transfer;
- v. The rights of the creditors of the trading contract counter-parties arising during the process of the sale, purchase or transfer of securities including the rights relating to the securities and the monetary equivalents thereto;
- vi. The conclusion and documentation of trading contracts and means of their proof and cancellation; and
- vii. The dealing in securities.

The provisions of this Article clearly emphasize the special character of securities and bring them out of the ambit of regular contractual relationships. Hence, the provisions of the Civil Code, the Commercial Code and the Companies Law do not apply in so far as they contradict with this Article, as evident from the language of the Article itself, which states that this Law shall apply notwithstanding the provisions of any other legislation in force.

Considering that MFs and ICs are licensed to issue and deal in securities for collective accounts, and are responsible for the management of such accounts on behalf of the shareholders, their activities clearly fall within the understanding of the provisions of Article (6), and as a result the rights and obligations of the parties resulting thereof shall be exclusively governed by the Securities Law.

Therefore, the relationship of the MF with any company registered in Jordan pursuant to the Companies Law shall be governed by the provisions of the Securities Law, in so far as this relationship concerns financial dealings in securities. Conversely, the Securities Law is not concerned with situations where the MF engages in contractual relationships for any other purposes that do not concern securities or financial dealings in general.

As explained in the context of analyzing the first issue, the Controller does not interfere in any contractual relationship that the MF may have with a company; the Controller's role is

limited to observing the corporate governance of companies registered with the CCD. This is similar to the relationship of banks with other companies; banks conduct their business operations in accordance with the banking laws and the Central Bank's regulations, and organize their contractual relationships in accordance with the general contract rules, all of which fall outside the mandate and jurisdiction of the Controller.

To conclude, the rights and obligations arising out of contractual dealings of the MFs and ICs relating to financial transactions in securities are exclusively governed by the Securities Law, whereas, their other contractual relations are typically governed by the general rules of contract law.

### 3. Interaction with other laws, regulations, and regulatory authorities in Jordan

---

#### i. Taxation:

Taxation in Jordan is regulated under various general laws, depending on the nature of the tax in question; the main taxes levied in Jordan are the following:

- **Income Tax, imposed by the Income Tax Law No. (57) for the year 1985:**

The Income Tax Law is a generic law, which in principle applies to all income generated to the benefit of a person within the Kingdom; the Law defines a “Person” to include both natural and legal persons. As explained above, the MF is a legal person created by virtue of the Securities Law, and is recognized as such pursuant to the provisions of the Jordanian Civil Code. Similarly, the IC is a company organized under the Companies Law as a legal person and therefore, both ICs and MFs are included in the definition of a Person.

A close reading of The Income Tax Law reveals that the Law differentiates between MFs and ICs; the profits of banks and other financial companies not charging interests are explicitly subject to income tax, as stipulated in Article (3) of the Law, while those of the MF appear to be implicitly included under the catch-all category, which subjects to income tax any profits or earnings from any source that is not listed and is not explicitly excluded or exempted by the provisions of the Income Tax Law and/or any other applicable law.

Notwithstanding the provisions of Article (3), Paragraph (B) of Article (7) provides for a partial exemption at (25%) of profits generated from buying and selling shares and bonds in and/or outside Amman stock market, and from the dividends of MFs earned by banks and financial companies, provided that no refunds are made for the profits of such companies in return for this exemption. As such, MFs and ICs are subject to income tax beyond the exempted percentage of 25% of their profits as per Paragraph (B) of Article (7), and the general rate for legal persons of 25%, applies. Additionally, Paragraph (B) of Article (3) explicitly subjects to tax the income realized out of Securities dealings outside the Kingdom, generated from funds located in the Kingdom.

It is worth noting that the draft amendments to the Income Tax Law were introduced by Government and are currently with Parliament; a review of the latest drafts, incorporating the comments of the Lower House of Parliament suggests that the tax status of an MF shall remain the same, while that of the IC, may become subject to a 35% rate beyond the exempted percentage of 25% of their profits as per Paragraph (B) of Article (7). However, it is hard to anticipate the nature of the final amendments and when such amendments will be adopted and enter into force.

- **General Sales Tax, imposed by the General Sales Tax Law No. (6) for the year 1994:**

According to the Law, a General Sales Tax is levied on any “service” provided after achieving a certain threshold under the Law, unless explicitly exempted; the tax is due upon issuing a tax invoice or when receiving the consideration for the service. Article (10) of the Sales Tax Law explicitly stipulates that sales of shares and stocks in companies and MFs and the sale of securities of all types are not subject to Sales Tax. Therefore, MFs and ICs are exempt from sales tax on their sales of stocks, shares and securities.

It is important to note that such exemption is limited to the sale of stocks and securities by MFs and ICs, which means that these entities may be subject to sales tax if the scope of “Services” extends beyond the exempt sale of stocks, to for example, offering financial advisory to clients. Or, if the Sales Tax Department chooses to consider that the whole concept of trading in stocks on behalf of investors as a service, and that such service is the preponderate part of the activities of an MF or an IC. However, existing MFs confirmed that they are not subject to sales tax and maintain that such a possibility is very unlikely to occur, as the primary service offered by such funds consists of the trading in securities and that advisory services are not and are unlikely to be offered independent from the trading itself.

- **Social Services Tax, imposed by the Social Services Tax Law No. (89) for the year 1953:**

Pursuant to Article (3) of the Law, the income tax levied on any kind of income is subject to a 10% Social Services Tax, except for the income tax paid by a company. As odd as it seems, such exclusion covers the income tax paid by ICs, and not the MFs, as MFs enjoy a legal personality that is different from a company’s.

- **The Additional Tax, imposed by the Additional Tax Law No. (28) for the year 1969:**

This type of Tax is levied in certain circumstances and against an exclusive list of products and/or services, and is not relevant to this subject inquiry.

In conclusion, MFs are considered as legal persons and are subject to tax obligations, as prescribed in the respective laws.

## **ii. The Commercial Code**

The Commercial Code of Jordan applies to the “Commercial Activities” as defined in Articles (6), (7), (8) & (9) of the Law, which do not explicitly include the activities that MFs and ICs carry. However, Paragraph (2) of Article (6) provides for a catch-all category which states that any such activity that is similar in nature and objectives to those stated in Paragraph (1) shall also be considered a commercial activity. Moreover, Article (9) of the Commercial Code, which

defines a “Merchant”, states that Merchants are those who undertake Commercial Activities as a profession, or such companies, which deal in a Commercial Activity, and Article (8) of the Code states that all the activities of a Merchant conducted for the purposes of its business shall be considered Commercial Activities, unless proven otherwise.

In principle, “Securities” are excluded from the Commercial Code and are strictly governed by the Securities Law; the Court of Cassation upheld this view in a decision stating that stocks are not considered commercial papers, and therefore are subject to the statute of limitations under the Civil Code, as opposed to the shorter terms of the Commercial Code.<sup>5</sup> However, the Court’s ruling addresses the effects arising from the nature of the Securities themselves, rather than the entity dealing therein.

Mutual Funds in both forms engage in the business of selling and buying Securities for a financial gain; according to the opinion of prominent experts in the Commercial Law domain, Securities are considered an intangible form of movables, and therefore, trading in Securities shall be considered as a Commercial Activity, in analogy with dealing with tangible movables, pursuant to Paragraph (1/a) of Article (6) of the Commercial Code. Such analogy is possible by virtue of Paragraph (2) of Article (6), considering that the objective of such trading is to make profit, similarly to trading in tangible movables. And thus, the Merchant status is extended to MFs and ICs pursuant to Paragraphs (a) and (b) respectively, of Article (9) of the Commercial Code.

In conclusion, the general provisions of the Commercial Code, including Bankruptcy apply to ICs by explicit reference in the Companies Law, and by extending the Merchant Status to the MFs, by virtue of Article (9) of the Commercial Code.

### **iii. Civil Code**

The Civil Code is a general mandate law and applies to all relationships and activities, in the absence of special laws governing the same, pursuant to Article (1448) of the Law. Consequently, the Civil Code applies to MFs only to the extent where the Securities Law and the instructions fail to address a particular aspect. As for ICs, the Companies Law has precedence over the Civil Code as it is a special law specifically enacted to regulate companies’ affairs, and therefore, would precede the Civil Code, in so far as the Securities Law and the instructions fail to address a particular aspect.

### **iv. Bankruptcy**

As explained under (ii) above, the merchant status is extended to MFs by virtue of Articles (6) & (9) of the Commercial Code, and as such, MFs are brought within the application of the Commercial Code and treated as “merchants” for all purposes including “Bankruptcy”.

---

<sup>5</sup> Court of Cassation decision No.140/2003 issued in 22/3/2004

With respect to ICs, the provisions of the Companies Law on bankruptcy apply, which in turn refer the matter to the general rules of bankruptcy under the Commercial Code.

In all cases, the bankruptcy and liquidation procedures for MFs must be subject to the provisions of Article (101) of the Securities Law which states that Assets of the Mutual Fund may not be attached to secure or collect any debts of the share or investment unit holders.

#### **v. Judicial Treatment**

As explained above, and according to the general principles of the Civil Code, the definition of a “Legal Person” includes any entity established by virtue of a law, and any group of persons or monies deriving their legal personality from the provisions of a law. As such, a MF is a recognized “Legal Person” by virtue of the Securities Law. This concept has been validated by several rulings of the Court of Cassation, which recognized the status of the Legal Person of entities established under their own laws and upheld the effects of their activities.

#### **4. Liability of the mutual fund entity, its management, and other service providers to third parties**

---

The liability of the MF and its management to third parties is a fundamental feature of the instructions to be issued for MFs according to Article (91) of the Securities Law. This Article explicitly mandates that the MF instructions shall regulate the duties and responsibilities of managers of the MF; “duties and responsibilities” is understood to include liability against third persons for actions of the MF.

In the absence of any special rules governing liability in the financial sector, or where the instructions fail to address a certain aspect, the general rules of liability under the Civil Code, apply. The Civil Code defines “tortuous acts” as any actions that cause damage, whether direct or causal, and states that any person who inflicts harm on others shall be liable for damages. Such liability extends to acts of deceit and can be assumed jointly and severally, as the case may be. Damages are typically decided by the competent court, taking into consideration the extent of the inflicted damages, any wasted gains as well as any moral damages sustained. It must be noted that the right to claim damages is subject to the statute of limitations and lapses in three years from the date of becoming aware of the damage and the causing entity, and with the lapse of 15 years from the date of the tortuous act, in any account. The Code explicitly states that any provisions disclaiming or exempting from liability for tortuous acts shall be deemed void

While the Civil Code lays down the grounds for liability, the Securities Law established specific rules that provide additional protection for investors in the financial market; any investor who suffers financial loss as a result of the sale of securities has the right to claim remedies for damages from the seller or the issuer, if such sale was carried out in a manner that violates the provisions of the Law. Investors are also entitled to restitution against financial losses incurred as a result of any incorrect, inaccurate or inadequate disclosure in a prospectus or any other report, including the omission of material facts or presenting misleading information. Such claims are subject to a two year lapse of time provisions from the date of securities sale, prospectus effective date, or the report actual or presumed filing date, as the case may be.

With respect to ICs, the liability of the board of directors shall be strictly subject to the Companies Law, which provides for detailed provisions addressing the liability of the board of directors of a public shareholding company.

## **5. Corporate governance of the mutual fund entity**

---

As a matter of principle, an MF is a distinctive legal entity created by virtue of the Securities Law, and is subject to its own corporate governance provisions, which may be different from those of a company.

Corporate governance provisions provided for in the Companies Law set out the rules that must be adhered to by the different types of companies that are organized pursuant to its provisions, including the basic structure of a company, the management, the board of directors, the competence of the general assembly, etc... however, the details that are specific to each individual company are left to the Articles and Memorandum of Association to decide.

The same is true for ICs, as they are established as PLC's and therefore, must adhere to the corporate governance rules of a PLC, in addition to the special rules provided for in Article (209) of the Companies Law. It is worth noting that there are no other corporate governance provisions elsewhere in the Jordanian legislation.

In conclusion, MFs follow their own distinct corporate governance prescribed by the provisions of the Securities Law. As for ICs, they follow the corporate governance provisions of public shareholding companies as stipulated in the Companies Law, subject to the provisions of Article (209) thereof.



**Sustainable Achievement of Business Expansion and Quality (SABEQ)**

**BearingPoint, Inc.**

**Salem Center, Sequleyah Street, Al-Rabiyeh**

**Amman, 11194 Jordan**

**Phone: + 962-6 550-3050**

**Web address: <http://www.SABEQ-Jordan.org>**