



Central Securities Depository of Iran LEGAL ENVIRONMENT



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INTRODUCTION

Central Securities Depository of Iran (CSDI) as a public joint stock company established in 2005 under section 7 article 1 of the Securities Market Act of the Islamic Republic of Iran. Under this section and its Articles of Association, CSDI is one of the main financial market infrastructures providers in Iran's capital market. Moreover, clause C of the article 99 of the Fifth Development Plan Act of Iran recognized CSDI as the entity in charge of clearing and settlement of trades in the exchanges and OTC markets in Iran.

CSDI plays a significant role in managing settlement risk which could lead to the systemic risks. To this purpose, CSDI has designed and launched the service of Settlement Guarantee Fund (SGF), along with other means, towards managing the risks related to the clearing house. Taking advantage of SGF service, the investors can to a large extent be assured of the fact that in case a party fails to meet the trade settlement obligations within the set time, the clearing house will be able to fulfill the obligations of the defaulting member within the settlement day.

Although CSDI is a Self-Regulatory Organization (SRO,) its operations and procedures are directly supervised by the Securities and Exchange Organization (SEO) as the regulatory and supervisory bodies in Iran's capital market. According to the Securities Market Act of the Islamic Republic of Iran and article 6 of

the articles of association of CSDI except a limited number of procedures, CSDI's regulation shall be ratified either by the SEO's board of the directors or the High Council of the Securities and Exchange . Currently the main CSDI stockholders are: Brokers, Banks, Tehran Stock Exchange, Iran FaraBourse, Iran Mercantile Exchange Co. Securities and Exchange organization and other financial institutions.

Laws and Regulations

Laws and regulations governing CSDI's activities are dividable into two groups; group A which is directly related to the establishment, activities and procedures of CSDI's operations. Except Securities Market Act of the Islamic Republic of Iran and the Law for Development of New Financial Instruments and Institutions, this group of regulations is mostly ratified by the High Council of the Securities and Exchange or the Board of the Securities and Exchange organization. Group B of laws are the public laws surrounding the activities of CSDI and impact them indirectly.

● **A: Laws and regulations directly impact CSDI's activities.**

1. The Securities Market Act of the Islamic Republic of Iran.

passed by the parliament in 2005 forms the primary source of law for Iran's capital market. CSDI as well as all the exchanges in Iran have been established according to this legislation. The act composed of seven sections. It introduced the High Council of the Securities and Exchange and Securities and Exchange Organization (SEO) as the key institutions and bodies, regulating and monitoring the market activities in Iran and the arbitration board of the market as the sole judicial body competent to deal with the disputes in the market. Moreover, it defined primary and secondary markets offences and punishments within the capital market.

2. The Law for Development of New Financial Instruments and Institutions.

Increasing need for new financial institutions and instruments entailed to the ratification of this act by the parliament in 2009. For the first time, the act defined and recognized Special Purpose Vehicles (SPV) and Mutual Funds as new entities financing projects and companies in the market. It described features and functions of SPV's and funds. In addition, the act made considerable changes in the Direct Taxation Act with respect to the taxes on transactions in the market. The statute determined taxes on the commodity and securities trade in the exchanges, SPV's and funds' income. The last section of the law adopted criminal and financial penalties in respect of breach of the laws and regulations in the market.

3. Articles of the Association of CSDI.

CSDI established as a public joint stock company under the Iranian Commercial Code in 2005. It is located in Tehran and its main responsibilities are; to establish and operate systems for registration, depository, custody and clearing of all the trades in the exchanges in Iran, act as an intermediary and agent in securities lending & borrowing, preparation and delivery of the reports required by brokerages, providing specialized services to the stock exchanges, commodity exchanges, issuers of the securities, financial institutions and other participants of the market, cooperation with the regional and universal exchanges and securities depository or settlement companies.

4. 6th Five-Year National Development Plan (2018-2022).

For many decades, medium-term economic planning has played an important role in Iranian economic life. Previously, the Iranian government designed and implemented several five-year and seven-year economic plans, focusing on private and public sector interactions, their investment requirements, structural reforms, and stabilization policies to achieve sustainable economic growth. These five-year economic plans constituted the medium-term framework and a platform to both promote the private sector and embark on public sector reforms aimed at a more equitable and just society. Eventually, the parliament approved the outline of a new five-year economic, cultural and social plan on 15th March 2017.

Clause (G) of article No.67 of Iran sixth Five-Year Development Plan covers important aspects of deployment of new technologies in advancement of domes-

tic and foreign projects. It is stated that:” Listed companies can adopt electronic means in order to hold general assembly, committing underwriting contract and to keep a record of securities transaction...”. Implementing electronic voting systems, electronic convocation and electronic issuing of stock certificate are also very well accentuated.

5.Iran Permanent Development Act.

Passed by the parliament in 2017 after the Fifth Five-Year National Development Plan Act became obsolete.The rules established to enhance the status of Iran’s financial market. Subsection C of article No 36 points out CSDI’s substantial role in clearing and settlement of securities. It is stated that :” after the transaction of listed securities in Securities Exchange or OTC markets and commodities transacted through Commodities Exchange, the clearing and settlement of securities are conducted through Central Securities Depository of Iran”.

6. The Regulations Governing Registration, Settlement and Clearing System in CSDI.

This regulation passed by the board of directors of the Securities and Exchange Organization on Aug. 4, 2009. It defined registration, depository, settlement and clearing procedures as the tasks of CSDI. Moreover the details of the procedures for each task as well as necessary documents needed to obtain ownership code by natural persons and legal entities and the time table for each activity clearly explained here. Under article 16 of this regulation “the settlement day for shares

trading shall be three days after execution of the transaction (T+3) and for trades in participation certificates one day after execution of the transaction (T+1).” Article 17 of this regulation states: The buyer’s broker shall be responsible for settlement of the securities purchased on the settlement day. In any case, the delivery of securities to the purchaser shall be subject to payment of funds and his settlement with the broker.

7. Settlement Guarantee Fund Rules.

passed by the Securities and Exchange organization in May 6th 2012, the rules established to cover the default risk of the trades in Tehran Stock Exchange and Iran FaraBourse Co. Members of the clearing house shall be the members of the fund. For this purpose they sign a membership contract with CSDI. The fund is managed by a committee with three members: CEO of CSDI, a member of the board of CSDI and a representative of the members of the clearing house who is elected by the Securities Exchange Brokers Association.

Other Laws and regulations are as follows:

- Bylaw governing Pledge of Securities passed by board of directors of the securities and exchange organization in 2009.
- Bylaw governing the securities transactions based on power of attorney passed by board of directors of the securities and exchange organization in 2010.
- Bylaw governing the establishment and operation of Portfolio Manager passed

by board of directors of the securities and exchange organization in 2010.

- The Regulations Governing Registration, Depository, Settlement and Clearing System of energy exchange passed by board of directors of the securities and exchange organization in 2010.
- Bylaw governing the issue, transaction and settlement of Certificate Merchandise Deposit passed by board of directors of the securities and exchange organization in 2016.

● **B: Laws and regulations indirectly impact CSDI's activities.**

1. The Anti-Money Laundry Act.

The Anti-Money Laundry Act of the Islamic Republic of Iran and its bylaws. (Passed by the parliament January 22, 2008), the law defined and determined money laundering offences and procedures to detect and deter money generated by illegal activities or money to finance terrorist activities. It established Anti-Money Laundering Supreme Council under the chairmanship of the minister of Economic Affairs and Finance. In order to implement the law in the capital market, Anti-Money Laundering Supreme Council passed regulations to recognize customers in the capital market, report the suspicious transactions and operations in the market, full authentication of clients and market participants' identities and backgrounds, reporting and investigating traders with suspicious trading patterns, keeping records of various transactions and developing systems to discover trading relations are being carried out meticulously shall be done under the bylaws.

2. Direct Tax Act.

Taxes on the trades in the exchanges regulated by Direct Taxation Act as follow:
Article 143: Ten percent (10%) of income tax gained from sale of the commodities listed on the commodity exchanges and ten percent (10%) of the income tax of the companies whose shares have been listed for trading on the domestic or foreign exchanges and five percent (5%) of the income tax of the companies whose shares have been listed for trading on the domestic or foreign OTC markets shall be exempted with the approval of the Organization as of the listing year to the year during which they have not been delisted from the listed companies on such exchanges or markets. The companies whose shares are listed for trading on the domestic or foreign exchanges or on the domestic or foreign OTC markets shall enjoy a tax exemption for double the said exemptions provided that they have at least twenty percent (20%) free-floating shares at the end of their fiscal year as confirmed by the Organization.

Article 143 (bis): Out of any transfer of shares and preemption rights of companies, whether Iranian or foreign, on the exchanges or on the licensed OTC markets, a flat tax for the amount of half percent (0.5%) of the sales value of shares and preemption rights shall be collected and, in this respect, no more funds shall be claimed as income tax for transfer of shares and preemption rights and value added tax for purchase and sale. The brokers of exchanges and OTC markets shall have to collect the given tax from the transferor during each transfer and pay it

into the account which has been assigned by the State Taxation Organization and shall, within ten days from the transfer date, send the relevant receipt along with a list containing the number and amount of shares sold and the preemption rights so transferred to the local Tax Affairs Department.

Note 1: All incomes of the mutual fund within the context of this law and all incomes gained from investment in securities under paragraph (24) of article (1) of the Securities Market Act of the I.R.I., ratified in 2005 and the proceeds derived from transfer of such securities or the proceeds earned from issuance and redemption of them shall be exempt from income tax and value-added tax as per the Value-Added Tax Act passed on May 23, 2008 and no tax whatsoever shall be claimed for the transfer, issuance and redemption of the foregoing securities.

Note 2: The profit and fees paid or allocated for securities as referred to in note (1) of this article, excluding the dividend and shares of companies, and the profit gained on investment units of funds, on the condition of registering these securities with the Organization, shall be regarded as parts of acceptable expenses for assessment of taxable income of such securities issuer.

Note 3: If any natural person or legal entity domiciled in Iran, who is the shareholder of the company listed on the exchange or OTC markets, sells his shares or preemption rights in foreign stock exchanges or foreign OTC markets, no tax whatsoever shall be levied on and collected in Iran in this respect.

Note 4: The mutual fund shall not be authorized to engage in any other economic activity whatsoever outside the area designated in the licenses issued by the Organization. 6

Articles 11 and 12 of the Law for Development of New Financial Instruments and Institutions:

Article 11: The SPV shall be exempt from payment of any tax whatsoever and transfer tax and charges and income tax for that category of the assets for which the funds are raised through issue of securities for public offering. The funds raised through issue of securities by such institutions shall be pooled in a special account and any withdrawal from such account shall take place under the supervision and with the approval of the Organization. The regulations governing the activities of the SPVs shall, within three months, be approved by the Securities and Exchange High Council upon the recommendation of the Organization.

Article 12: The proceeds gained from selling assets to the SPV so as to provide financial resources through public offering of securities shall be exempt from tax and no tax and charges whatsoever shall be levied on the transfer of such securities. The depreciation expenses arising from assets value appreciation in the repurchase of the same assets by the seller, in whichever manner, shall not be regarded as parts of the tax deductible.

3. General Policies of the Article 44 of the Constitution of the Islamic Republic of Iran.

Under article 44 of Iran's constitution the public sector, i.e. government had owned and operated all large-scale industries, primary industries, foreign trade, large mines, banking, insurance, power supply, dams and large irrigation channels, radio and television, post, telegraph and telephone, aviation, shipping, roads, rails and the like, which are public property and at the disposal of the Government. In 2005 the general policies of the article 44 of the Constitution, with the aim to expand private sector and prevent from governmental sector expansion were announced by the supreme leader. According to these principles the government has been obliged to relinquish any activity, including continuation and operation of previous activities that were covered under Article 44, and cede them (at least 20 percent annually) to the private and cooperative sectors by the end of the Fourth Five-Year Development Plan. The privatization procedure of the state owned entities in Iran carried out through the capital market. CSDI as the sole clearing and settlement entity in Iran' capital market played its key role in the Iran's economy's privatization procedure under the general policies.

4. Iran's Commercial Code.

The code composed of four parts. Merchants and Business Transactions, Commercial Companies, Negotiable Instruments and Bankruptcy. This code governs the public or private companies registered in Iran. The Code addresses various aspects of the companies' activities from their establishment to corporate governance, bankruptcy and liquidation.

5. Regulations governing foreign investment in the capital market.

- Foreign Investment Promotion and Protection Act (FIPPA). Passed in 2002, FIPPA allows foreign investment in all sectors of Iran's economy. This legislation and its bylaw impact foreign investments in the capital market regarding the maximum amount of foreign investment permitted in different sectors of Iran's economy and capital market as well.
- Regulations on paragraph C, Article 15 of the Law of the Fourth Economic, Social, and Cultural Development Plan of the Islamic Republic of Iran, concerning the investment of foreign entities in the Tehran Exchange. (Approved by the Cabinet in 1 June 2005)
- The rules governing issuance of securities transactions license to foreign investors.
- The bylaws governing foreign investment in the exchanges and OTC markets.

Moreover, the related approvals of the High Council of the Iranian Capital Market and the board of the directors of the Securities and Exchange Organization of Iran as the supervisory and regulatory bodies of the whole capital market of Iran fall within this group. The High Council of the Iranian Capital Market, and the Securities and Exchange Organization of Iran are the two main institutions who regulate and supervise the CSDI's activities directly. Among the members of the High Council of the Iranian Capital Market, Ministry of the Economic Affairs and Finance is monitoring the CSDI's activities indirectly.

To fulfill its responsibilities under the laws and regulations, the CSDI is the main shareholder of the following companies:

- Capital Market Central Asset Management Company: the company offers specific services to the intermediary institutions (SPVs) that are in charge of issuing Islamic financial instruments such as Sukuk in Iran's capital market. CSDI owns 49% of the share of this company.
- Samat Samaneh Company: offers the information technology related to the post trade procedures and almost all of it (99.98% of its shares) belongs to the CSDI.

Other Laws and regulations are as follows:

- Civil Law passed by the parliament in 1933.
- The Civil Procedure Act passed by the parliament in 1978 and recent amendments, 2017.
- The regulation on article 218 of Direct tax law passed by Ministry of Justice in 1988.
- The regulations governing the Issue of Sukuk -al-Murabaha passed by board of directors of the securities and exchange organization in 2012.
- The regulation governing article 50 of Social Security act passed by Ministry of Justice in 1976.
- Bylaw governing the issue of Gharz-al-Hasaneh passed by board of directors of the securities and exchange organization in 2012.
- Bylaw governing the issue of Sukuk al-Istisna passed by board of directors of the securities and exchange organization in 2014.
- Bylaw governing the margin trading in Tehran Exchange and Farabourse by board of directors of the Securities and Exchange Organization in 2013.

**Address: #13, Naderi Street, Italy
Intersection, Keshavarz Boulevard,
Tehran –Iran**



**<http://en.csdiran.com/>
Email: intl@csdiran.com
Tel: +982142315**