

Liberalization of SOFAZ investment rules



Recently, the President of Azerbaijan issued a number of decrees which liberalize the manner in which SOFAZ may operate and manage its assets. Until recently, SOFAZ pursued an extremely conservative investment policy. However, the recent amendments to the SOFAZ investment rules are important, in that they significantly expand the areas and composition of assets in which SOFAZ may invest.

Amended Presidential Decrees

Pursuant to Presidential Decrees (i) No. 519, dated 27 October 2011; (ii) No. 478, dated 26 July 2011; (iii) No. 520, dated 28 October 2011; and (iv) No. 477, dated 26 July 2011, the following Presidential Decrees were amended:

- (a) Decree No. 240 of the President of the Azerbaijan Republic, “On the Establishment of the State Oil Fund of the Azerbaijan Republic,” dated 29 December 1999 (the “**Decree on SOFAZ**”);
- (b) The Regulations of the State Oil Fund of the Azerbaijan Republic, approved by Decree No. 434 of the President of the Azerbaijan Republic, dated 29 December 2000 (the “**SOFAZ Regulations**”);
- (c) The Rules “On the Holding, Placement and Management of Foreign Currency Assets of the State Oil Fund of the Azerbaijan Republic,” approved by Decree No. 511 of the President of the Azerbaijan Republic, dated 19 June 2001 (the “**SOFAZ Investment Rules**”).

(a) Decree On SOFAZ Establishment

According to the Decree On SOFAZ Establishment, the multiple sources of revenues flowing into SOFAZ consisted, *inter alia*, of revenues generated from the transfer of assets by investors within the framework of oil and gas contracts to SOCAR, SOFAZ or other authorized governmental authorities.

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According to the recent amendments, such investors may transfer assets only to authorized governmental authorities, and no longer to SOCAR or SOFAZ, although revenues generated from the sale of transferred assets are still listed as one of the sources of revenue for SOFAZ.

(b) SOFAZ Regulations

The amendments to the SOFAZ Regulations mirrored the amendments made to the Decree On SOFAZ Establishment and also eliminated the previously existing provision which required that SOFAZ funds be invested in banks and assets having investment grade ratings.

Following this amendment, SOFAZ may now invest its funds in banks and assets that have non-investment grade ratings.

(c) SOFAZ Investment Rules

Unlike the amendments made to the Decree On SOFAZ Establishment and the SOFAZ Regulations, the SOFAZ Investment Rules were amended extensively:

- SOFAZ is now expressly permitted to invest in assets valued in the currencies of (i) the G7 Countries (the USA, Germany, the UK, France, Italy, Canada, and Japan); (ii) the Euro Zone countries; (iii) the Russian Federation; (iv) Turkey; and (v) other countries, the long-term credit rating of which is not lower than “A” (Standard & Poor’s, Fitch) or “A2” (Moody’s).
 - ▶ Investments in assets valued in the currencies of other countries are still allowed, subject to the condition of hedging against the fluctuation risk of such currency in relation to the U.S. Dollar.
 - ▶ The relative ratios of the basket of foreign exchange reserves are now to be indicated in SOFAZ Investment Policy.
- There are new requirements for foreign financial managers engaged by SOFAZ. Namely, such foreign managers or their parent companies must have: (i) an investment grade credit rating (Standard & Poor’s, Fitch, or Moody’s); or (ii) 5 years of positive experience in assets management; or (iii) competence in managing assets with a value of at least USD 1 billion.
- SOFAZ is now no longer required to establish minimum satisfactory credit ratings of the companies or assets in which it invests as part of its management of the credit risks.



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- The composition of the SOFAZ investment portfolio has been expanded to include:
 - ▶ deposits in central and commercial banks, as well as other financial institutions;
 - ▶ debt obligations issued by countries, state enterprises, international financial institutions, commercial and other entities that have investment grade ratings (Standard & Poor's, Fitch, or Moody's), whether or not such debt obligations themselves have investment grade ratings;
 - ▶ debt obligations with investment grade ratings (Standard & Poor's, Fitch, or Moody's) issued by countries, state enterprises, international financial institutions, commercial and other entities, whether or not the issuers of such debt obligations themselves have investment grade ratings;
 - ▶ shares included in stock exchange indexes having an international reputation;
 - ▶ mutual funds, including shares (participatory interests) in alternative investment funds;
 - ▶ gold bullion that satisfies the requirements applied by the London Bullion Market Association;
 - ▶ real estate;
 - ▶ non-investment grade securities and deposits in non-investment grade institutions, provided that: (i) their respective credit ratings are not lower than "BB-" (Standard & Poor's, Fitch) or "Ba3" (Moody's) and (ii) such investments constitute no more than 5% of the entire investment portfolio. In such cases SOFAZ may open bank accounts with, become a counterparty to, or engage for depository services, banks and other financial institutions having non-investment grade credit ratings (but not lower than "BB-" (Standard & Poor's, Fitch) or "Ba3" (Moody's)).
- The prohibitions against the investment by SOFAZ in precious metals and stones, real estate and goods are now eliminated.

For further information, please contact:

Kamal Mammadzada

Partner

E: kmammadzada@salans.com

Ulvia Zeynalova-Bockin

Associate

E: uzeynalova-bockin@salans.com

Salans Baku

Hyatt International Centre

Hyatt Tower 2

1033 Izmir Street

AZ 1065 Baku

Azerbaijan

T: +994 12 490 75 65

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