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# CLIENT NOTE

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## SMALL ISSUANCES AND SUPPORTING ECONOMIC ACTIVITY THROUGH FUNDING LIQUIDITY: SOME THOUGHTS ON THE ROLE OF STATE IN HARD TIMES



### OVERVIEW

In recent weeks, we have witnessed extremely negative impacts of COVID-19 on global economy. Financial markets, banks and other industries have been affected by severe economic downturn.

Due to the COVID-19 pandemic Armenian businesses are suffering greatly. In addition to the available support packages, there might be alternative and innovative investment and financing packages available through public issuance of securities. Here, we discuss how.

Within this disturbing picture, however, some industries seem to suffer more. Thus, many SMEs providing tourism, hospitality or travel services or operating in the sphere of manufacturing are facing serious challenges caused by total collapse of the industries. This, in its turn, results in fatal consequences (often – loss of job) for people employed in those industries.

Under the circumstances described above, many governments and international financial institutions have initiated support packages with the aim of assisting vulnerable businesses. Earlier we published two Client Notes ([Government Support](#) and [Support to SMEs](#)) on the Armenian Government's support packages. The first one envisages, in a nutshell, following methods of assistance:

- (a) co-financing at 0% interest rate of a part of the loan principal with the same repayment period provided that State will partially take the risk for the repayment of loan principal;
- (b) re-financing at 0% interest rate of a part of the loan principal with the same repayment period;
- (c) subsidy of a part of loan interests during the whole term of the loan without repayment risk-taking.

The second package, aimed at supporting SMEs, envisages providing loans for financing the following costs:

- (a) payment of salaries or other types of remuneration (no more than AMD 300,000.00 monthly for a maximum of three months per employee);
- (b) payment of taxes or other state fees;
- (c) purchase and import of material to be used in the RA for production by the same entity;
- (d) payment for utility services for a maximum of three months;
- (e) rental subsidies.

Admitting the importance and usefulness of the assistance methods described above, it is necessary to stress, however, that those will help to mitigate the negative impacts of the crisis to a certain extent only. To achieve better results in coping with the economic shocks, the Government will have to consider alternative methods for providing support to vulnerable industries.

### Funding liquidity through purchase of securities as an alternative method of support

Funding liquidity of enterprises by the State through purchasing securities issued by those enterprises may prove to be one of the most effective methods to support businesses in these troubling times. Currently a number of states have initiated such support packages.



For example, the Bank of England has introduced the COVID Corporate Financing Facility (CCFF) – a lending facility for larger firms with outstanding financial and tax history, which currently suffer from cash shortages due to COVID-19. The essence of support suggested by CCFF is providing financing to eligible companies through purchase of short-term corporate debt – commercial papers.<sup>1</sup> The UK scenario aims to provide support to large enterprises having solid role in the economy of the country.

## Financing SMEs in Armenia



This Client Note, however, is mainly focused, in the context of Armenian legislation, on possibilities of providing assistance to small and medium enterprises affected by the economic shock. For this reason, further in this Client Note we will analyze the relevant laws and regulations, by virtue of which SMEs can issue securities without being obligated to comply with very strict requirements and will introduce our suggestions regarding the possible scenarios and methods of

support the Government may employ.

## Small Issuances

Article 6 (1) (4) of the Law of the Republic of Armenia on Securities' Market provides that the requirement of publishing a prospectus shall not apply to those public offerings, when the overall issuance or sale price of securities offered does not, within 12 months, exceed the amount established by normative legal acts of the Central Bank. The mentioned amount is specified in Paragraph 10 (3) of the Regulation 4/04 of the Board of the Central Bank on Prospectus and Reports of Reporting Issuers – AMD 40 million. Furthermore, Article 6 (7) of the Law on Securities' Market stipulates that in such case the issuer shall notify the Central Bank within 15 days after completion of the allocation. The form of the Notification is defined in Appendix 5 to Regulation 4/04. It shall contain, in particular, the following information:

- (a) class of securities,
- (b) quantity of issued securities,
- (c) face value per unit,
- (d) overall face value,
- (e) start of allocation (day, month and year);
- (f) end of allocation (day, month and year);

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<sup>1</sup> Find more at <https://www.bankofengland.co.uk/news/2020/march/the-covid-corporate-financing-facility>.

- (g) date of adoption by the authorized body of the issuer of the resolution on issuance (day, month and year);
- (h) quantity of factually allocated securities;
- (i) average allocation price;
- (j) overall price of factually allocated securities.

Thus, small issuances with overall issuance or sale price of up to AMD 40 million within 12 months comprise an exception from strict regulatory requirements. In other words, the issuers of such securities are not required to publish a prospectus and comply with strict reporting requirements associated therewith. Instead, the issuers are just obliged to submit to the Central Bank a Notification specifying essential information on securities.

Furthermore, as it is evident from the provisions cited above, the regulations use the term “securities”, which means that issuers of both debt and equity securities may benefit from the exception at issue.

In our opinion, the absence of strict requirements with relation to these issuances, including, among others, the fact that such issuances do not require very much resources, creates a perfect opportunity for SMEs facing cash shortages due to the economic downturn to attract financing. At the same time, we are sure that small issuances may be a useful tool for initiating effective state support mechanisms to assist small businesses coping with the crisis.

### Support by the Government

In the current situation, the Government may offer small and medium businesses to issue securities, which will later be purchased with the purpose of funding the issuer. As the forecasts predict that the COVID-19 crisis will last for several years, we think that short-term financing will not be suitable in such situation and suggest that the Government focuses on medium-term financing.

### Eligibility criteria

In compliance with the best international practice, the Government should establish eligibility criteria for both the issuers and the securities. These criteria should mainly depend, of course, on specific policy implications inherent to a particular state. Taking into account the rationale of supporting vulnerable small and medium enterprises, as introduced in this Client Note, we suggest the following issuer eligibility criteria:



- (a) the issuers operating in a vulnerable sector. For greater effectiveness we suggest specifying an inclusive list of those sectors. Such list may include, in particular, internal tourism, hospitality and travel industries, as well as some vulnerable sectors of manufacturing;
- (b) the issuers should fall under the classification of extra-small, small and medium enterprises established by the Law of the Republic of Armenia on State Support to Small and Medium Business;
- (c) the issuers should have been in good financial condition before COVID-19 outbreak;
- (d) the issuers should have complied with all tax obligations within a specified period of time before COVID-19 outbreak.

As to securities eligibility, the following eligibility criteria may be specified:

- (a) in case of debt securities, maturity period shall be between 2 and 10 years;<sup>2</sup>
- (b) minimum amount of offer.

### Possible scenarios of the Government's support

Here we will consider scenarios, which may be employed by the State for the purpose of supporting businesses through funding liquidity with the help of small issuances. In particular, we suggest three following scenarios:

- (a) the Government purchases all of the issued securities, thus providing financing to SMEs;
- (b) the issued securities are traded on the Stock Exchange. The Government assumes an obligation to the investors to purchase the securities within a certain period of time;
- (c) while a part of the issued securities is purchased by the Government, the other part is traded on the Stock Exchange and purchased by other investors. The Government and the other investors bear the risk of losses together

### Regulatory amendments

While the existing regime can be applicable to a lot of companies, some quick improvements could indeed increase the use of this instrument.

First, the threshold amount of issuance, for which no prospectus requirement applies – sale or issuance price of AMD 40 million within 12 months, is very low. For the purpose of providing bigger opportunities to affected small and medium business, we suggest establishing a higher threshold of AMD 200 million for the securities issued with the aim to benefit from the support package discussed in this Client Note.

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<sup>2</sup> As has been mentioned earlier, short-term financing may not suffice for facing the challenges of COVID-19 crisis. That is why it is important to implement medium-term financing strategies.

Second, under paragraph 11 of the Rules of Armenia Securities Exchange on Listing and Admission on Trading of Securities, the overall face value of bonds admitted to trade on the stock exchange shall be at least AMD 100 million. Under such circumstances, in case the threshold for issuance without publication of a prospectus is AMD 40 million within 12 months, the securities cannot be admitted to trading on the exchange. Thus, an exception can be established for securities issued for purpose of benefiting from the suggested support package.



In case of necessity, other requirements established by the Exchange Rules<sup>3</sup> may be eliminated or postponed as well.

### Next Steps

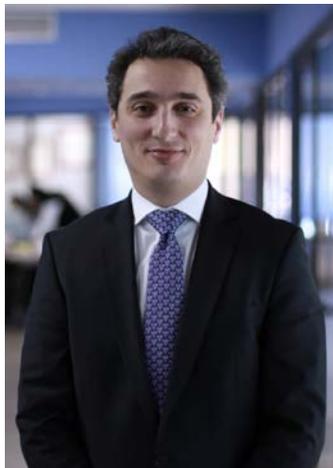
Copy of this note shall be submitted to the Government of Armenia and the Central Bank of Armenia. Once we make some progress, we will inform all our clients on these achievements.

**NOTE: This material is for general information only and is not intended to provide legal advice**

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<sup>3</sup> E. g. mandatory requirements on publication of reports on the website, having a board of directors, etc.