LISTING OF SIFS AND SICARS: HURDLES AND SOLUTIONS

SIFs and SICARs are investment vehicles reserved for sophisticated investors. Their legal regimes were therefore designed on the premise that investors in those vehicles do not need the same level of protection as retail investors. SIFs and SICARs enjoy a very flexible corporate and regulatory regime. The same features that have made SIFs and SICARs successful have to some extent become obstacles when it comes to organising a listing of their securities. However, experience shows that such hurdles can be circumvented.

The purpose of this paper is to discuss some issues relating to the admission to listing on the Luxembourg Stock Exchange ("LxSE") of specialised investment funds ("SIFs") subject to the Law of 13 February 2007 relating to SIFs (the "SIF Law") and investment companies in risk capital ("SICARs") subject to the Law of 15 June 2004 relating to SICARs (the "SICAR Law"). It particularly addresses the questions of (i) whether the listing of SIFs and SICARs is compatible with applicable ownership restrictions and (ii) how to cope with certain issues relating to the settlement of securities issued by SIFs and SICARs contemplating a listing on the LxSE.

The LxSE operates two markets. Its main market is a regulated market within the meaning of Directive 2004/39/EC, the so-called MiFID. A second market, which is not a regulated market according to MiFID[1], the Euro MTF, was established in July 2005 so as to provide issuers with an alternative to certain constraints inherent in EU regulated markets. Issuers may elect to trade their securities either on the main market or on the Euro MTF. The rules applicable to the ongoing reporting requirements for issuers and the contents of and approval process for prospectuses vary according to the market on which the securities are admitted to listing and trading[2]. Yet, the conditions which apply to the admission of securities to listing and trading are similar for both markets.

As the issues discussed in this paper arise in relation to a listing on either of the LxSE's markets, no distinction will be made in the developments below between the two markets operated by the LxSE.

COMPATIBILITY OF APPLICABLE OWNERSHIP RESTRICTIONS WITH THE REQUIREMENT OF FREE TRANSFERABILITY

In order to be admitted for listing on the LxSE, securities must be freely transferable.[3] This is a key condition for a listing.

Yet, securities issued by SIFs and SICARs are reserved for well-informed investors within the meaning of the applicable law[4].

The question was thus raised whether these ownership restrictions would be an impediment to the listing of SIFs and SICARS on the LxSE.

It must be stressed that this issue is not specific to SIFs and SICARs. Any type of securities which are restricted to certain categories of investors is similarly affected. The issue particularly applies to the institutional classes of shares or units of Luxembourg undertakings for collective investment ("UCIs") that are governed by the Law of 20 December 2002 relating to UCIs (the "Law of 2002") and have however been admitted to listing on the LxSE.

One may also recall that some UCIs that were subject to the Law of 19 July 1991 relating to UCIs whose securities are not intended to be placed with the public, the so-called institutional UCIs, were admitted to listing on the LxSE.

Quite shortly after the adoption of the SICAR Law, a first project of listing of a SICAR was submitted to the LxSE. Although this project did not finally materialise, the listing of a SICAR was then admitted as a matter of principle.

In light of the foregoing, when the SIF Law was adopted in February 2007, not much debate about the possibility to list SIFs on the LxSE was expected.

Surprisingly, and quite quickly after the SIF Law entered into force, the compatibility of the ownership restrictions applicable to SIFs with the free transferability requirement became a hot issue on the marketplace.

There was in fact no reason for precluding SIFs from applying the same solutions as those tested with other investment vehicles whose securities are reserved for certain categories of investors.

Finally, after some discussion, it is now clear that such solutions are acceptable in the context of SIFs and SICARs.

In order to comply with the free transferability requirement, the LxSE does not allow trades made on its markets to be nullified on the grounds that the trades resulted in a transfer of securities issued by a SIF or a SICAR to an investor who does not qualify as a well-informed investor.

In such a case, the solution is to be found *a posteriori* either through compulsory redemption mechanisms or the right for the representatives of the SIF or the SICAR to instruct the non-eligible investor to transfer the securities acquired to a well-informed investor. Appropriate wordings allowing such mechanisms must be inserted in the offering and constitutional documents of SIFs and SICARs in that respect.

SETTLEMENT ISSUES

The settlement of transactions executed on the LxSE must in principle be arranged via a recognised system of the LxSE[5], such as the systems operated by Clearstream Banking Luxembourg ("Clearstream") and Euroclear Bank ("Euroclear").

Acceptance of securities for settlement in Clearstream or Euroclear is at the discretion of such institutions.

The application made by a SIF or a SICAR for acceptance in Clearstream or Euroclear must be accompanied by the final offering document or last available draft of such document.

The approval process mainly focuses on checking that there are no restrictions involving operational constraints that would make the securities incompatible with the system in question.

Such restrictions may be classified in two categories, namely waivable restrictions and unacceptable conditions.

Securities to which waivable restrictions are attached are not accepted in the system,

unless the settlement agent concerned is provided with a waiver letter from the issuer discharging the settlement agent from ensuring that the restrictions are applied.

In the event of an unacceptable restriction, the securities are considered incompatible by the settlement system and will not be accepted.

Acceptance in systems operated by Clearstream and Euroclear is decided on a case by case basis. There is no exhaustive list of what is to be considered as a waivable restriction or an unacceptable condition. Besides, a restriction may by considered compatible with a settlement system operated by one of these institutions and incompatible with the settlement system operated by the other.

Some guidelines have been issued by Clearstream in that respect[6].

Waivable restrictions relate for example to contingent deferred sales charges (i.e. redemption fees based on the length of the holding period), early redemption fees, restrictions on redemptions or lock-up periods, beneficial and transfer restrictions linked to capital calls, defaulting shareholders process and beneficial ownership restrictions. With regard to this last example, it should be noted that Clearstream has taken the view that although a SIF is reserved for well-informed investors, this does not constitute a beneficial ownership restriction requiring a waiver letter. The same applies to a SICAR.

Unacceptable restrictions include in particular investment vehicles calculating and paying daily dividends, investment vehicles paying the investment advisor by a compulsory transfer of shares, equalisation factor systems where the performance fee is paid by compulsory redemption of shares or closed-ended funds where no secondary market trading is allowed.

In principle, securities not eligible for settlement in a system recognised by the LxSE may not be listed on the LxSE.

The LxSE may however authorise specific settlement methods for transactions in securities or categories of securities with specific features making them incompatible with settlement systems recognised by the LxSE.[7]

Such settlement methods are referred to as "deferred settlement mechanisms" in order to distinguish them from settlement systems recognised by the LxSE.

Deferred settlement mechanisms are only authorised for securities presenting unacceptable conditions. In other words, an issuer may not freely opt between settlement through a recognised system or through the implementation of a deferred settlement mechanism. An application must first be made to recognised systems. It is only if there is no possibility for the securities to be accepted for settlement in a recognised system that a deferred settlement procedure may be submitted to the LxSE.

The issuer of the securities will be responsible for the procedure for settlement of transaction through a deferred settlement mechanism which must allow settlement within reasonable time limits.

There is no pre-determined deferred settlement procedure defined by the LxSE. The procedure should be agreed by the issuer or its agent. The contemplated procedure is subject to approval by the LxSE and must be properly disclosed in the offering document of the issuer or other document specifically prepared for that purpose.

The LxSE requires that only intermediaries established in Luxembourg can be designated to establish such a deferred settlement procedure. SIFs and SICARs will typically appoint their registrar and transfer agent for that purpose.

Again, such settlement issues are not specific to SIFs and SICARs. However, whereas in theory they apply similarly to SIFs, SICARs and UCIs governed by the Law of 2002, in practice the chances of having discussions in the context of SIFs and SICARs are higher. Due to the very flexible corporate framework offered by the SIF and SICAR regimes and the fact that such vehicles target well-informed investors, many structures established under the SIF and SICAR regimes are more complex than structures usually organised under the Law of 2002. Sophisticated structures established under the form of a SIF or a SICAR are more likely than simpler structures to contain restrictions involving operational constraints that may make the securities issued incompatible with a recognised system of the LxSE.

Conclusion

The main issues discussed in the context of the submission of the first projects to list SIFs and SICARs relate to the compatibility of applicable ownership restrictions with the requirement of free transferability and issues relating to settlement of securities.

If such issues are now clearly resolved in principle, the practicalities of the implementation of the solutions remain a key point that should be discussed with the different parties involved at an early stage, when the listing of a SIF or a SICAR is contemplated. In particular, it is important to determine rapidly whether the securities to be listed are compatible with a settlement system recognised by the LxSE. If not, the deferred settlement process should be discussed early on with the intermediary which will be responsible for operating the procedure, typically the registrar and transfer agent.

As such discussions may take some time, it is strongly recommended that the draft documentation be communicated in parallel to the different authorities and parties involved. ■

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[1] It should be noted that *the Commission de Surveillance du Secteur Financier* recognises the Euro MTF as another regulated market, which operates regularly and is recognised and open to the public within the meaning of Part I of the Law of 20 December 2002 relating to undertakings for collective investment.

[2] This being said, the applicable prospectus regime varies not only depending on the market on which the securities are admitted, but also depending on the type of issuer. In particular, it should be pointed out that SIFs of the closed-end type and SICARs admitted to trading on the main market operated by the LxSE fall within the scope of the prospectus regime defined by Directive 2003/71/EC, the so-called Prospectus Directive. The different prospectus regimes applicable to SIFs and SICARs admitted on the LxSE will however not be discussed in this paper.

[3] Rules and Regulations of the Luxembourg Stock Exchange (entry into force 1st November 2007), Part I, Chapter 5, item 502 and Chapter 7, item 703.

[4] A well-informed investor within the meaning of the SIF Law and the SICAR Law is an institutional investor, a professional investor or any other investor who certifies in writing that he/she/it is a well-informed investor and either invests a minimum of 125, 000 Euro in the SIF or the SICAR, or has been the subject of an assessment made by certain categories of licensed professional of the financial sector, as listed by the applicable law, certifying his/her/its expertise, experience and knowledge in adequately appraising an investment in the SIF or the SICAR.

[5] Rules and Regulations of the Luxembourg Stock Exchange (entry into force 1st November 2007), Part 3, Chapter 4, item 4601.

[6] See notably "Guidelines for acceptance of Investment Fund Shares for custody and settlement in Clearstream Banking Luxembourg", Document number 6448, www.clearstream.com.

[7] Rules and Regulations of the Luxembourg Stock Exchange (entry into force 1st November 2007), Part 3, Chapter 4, item 4602.