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CSX Decision: Empty Relief?

In a much discussed and awaited decision, the U.S. District Court for the Southern District of New York (the "Southern District") recently concluded in *CSX Corporation v. The Children's Investment Fund Management (UK) LLP, et al.* (S.D.N.Y. No. 08 Civ. 2764) that the defendants—two hedge funds that are waging a proxy fight against CSX—were deemed to be the beneficial owners of stock that was the reference security in certain cash-settled, total return equity swaps and that the defendants had not disclosed their holdings in the manner required by the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The decision reached by Judge Lewis Kaplan of the Southern District was fact-specific, and facts that were in contention seemed generally to be decided in the light most favorable to the plaintiff, CSX. Judge Kaplan enjoined the defendant hedge funds and their individual principals from further securities law violations, but did not restrict their voting of their shares in the upcoming meeting of shareholders. This decision has been appealed to the Second Circuit Court of Appeals by both parties.

In a case that was expedited by the Southern District, CSX brought an action against The Children's Investment Fund Management (UK) LLP and The Children's Investment Fund Management (Cayman) Ltd. (collectively, "TCI") and 3G Fund L.P., 3G Capital Partners L.P. and 3G Capital Partners Ltd. (collectively, "3G"), claiming that (a) TCI failed to disclose beneficial ownership of CSX shares that were the subject of its total return swaps and (b) TCI and 3G failed to timely file a Schedule 13D after forming a group. CSX sought to have the court enjoin TCI and 3G from voting their shares at its upcoming annual meeting of shareholders.

CSX argued that due to the influence that TCI had over its swap counterparties, TCI was the beneficial owner of the CSX shares referenced in the total return swaps, and that TCI failed to comply with the securities laws by not filing a Schedule 13D upon acquiring 5 percent ownership of the CSX shares. TCI, on the other hand, contended that it did not have beneficial ownership of the referenced CSX shares under Section 13(d) of the Exchange Act because it did not have any investment or voting power over the stock and, therefore, was not required to report beneficial ownership of the CSX shares referenced in the total return swaps. In addition, TCI and 3G stated that they timely disclosed that they had formed a "group" soon after they had decided to do so. The court believed that TCI was able to "influence" the voting and investment of its swap counterparties and that it would be ignoring the substance of the arrangement if beneficial ownership were determined solely by focusing on whether TCI clearly had investment or voting power over

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CSX shares referenced in the total return swaps. However, the Southern District declined to take a position on whether the cash-settled, total return swaps constitute beneficial ownership, as a general matter, under Rule 13d-3 of the Exchange Act. Instead, the court relied on a provision of that rule that attributes beneficial ownership of a security to a person who enters into an arrangement as part of a "plan or scheme to evade the reporting requirements of Section 13(d)." In this instance, Judge Kaplan determined that TCI had engaged in such a "plan or scheme" and, therefore, beneficially owned the CSX shares referenced in the total return swaps for purposes of reporting beneficial ownership under Section 13(d).

In an *amicus* letter from the Division of Corporation Finance of the U.S. Securities and Exchange Commission (the "SEC") prior to the Southern District's decision, the SEC staff stated that "as a general matter, a person that does nothing more than enter into an equity swap should not be found to have engaged in an evasion of the reporting requirements." However, as the *amicus* letter also referred to the concept of a "plan or scheme" (though in the context of suggesting that such is generally not the case in a swap transaction), Judge Kaplan found sufficient ambiguity in the letter to justify the court's making a determination as to TCI's and 3G's intent.

Judge Kaplan also held that TCI and 3G had formed a "group" that had acquired more than 5 percent of the deemed beneficial ownership of the CSX shares months prior to filing a Schedule 13D, based on facts taken exactly as CSX presented them. Judge Kaplan refrained from restricting voting of the CSX shares by TCI and 3G due to the fact that CSX was unable to prove "irreparable harm." Further, Judge Kaplan stated that "any penalties for defendants' violations must come by way of appropriate action by the SEC or the Department of Justice."

While some have described this decision as an empty victory for CSX in light of Judge Kaplan's refusal to enjoin the defendants from voting their shares in the current proxy fight, the permanent injunction he has issued against the two hedge funds and their principals should not be taken lightly. Such an injunction can have serious collateral consequences, involving both required disclosures and "bad boy" disqualification from certain useful securities law exemptions and procedures.

It should also be noted that in a June 17, 2008 letter to Chairman Christopher Cox of the SEC, New York Senator Charles Schumer requested that the SEC clarify the treatment of equity swaps and indicated that legislation may be needed to provide "serious" penalties for disclosure violations.

The fallout from this decision remains to be seen and will, to an extent, depend on the future (and expedited) ruling of the Second Circuit Court of Appeals (the "Second Circuit"), which may clarify the positions taken by the Southern District. Under the SEC's traditional position, as reiterated in the *amicus* letter mentioned above, swaps would generally not give rise to beneficial ownership of shares in the absence of an agreement or understanding with respect to the voting or disposition of such shares. However, because the Southern District's holding in this case requires an analysis of the investor's intent, investors that will exceed the 5 percent threshold as a result of the use of swaps will have to decide whether to (a) continue following the SEC's position, (b) to take a more conservative approach and deem their swaps to constitute beneficial ownership, or (c) to defer having to make this call by avoiding swaps altogether.

Determining whether a person or group is a 10 percent owner for purposes of Section 16 under the Exchange Act is based on the same Section 13(d) definition interpreted by Judge Kaplan in this decision, so it is possible that Section 16 plaintiffs may rely on this decision in making claims against stockholders with swaps that would put them above 10 percent. That definition is also used in most "poison pill" plans and many other corporate governance provisions relevant to corporate control issues, magnifying the possible collateral consequences of this decision, if it stands.

Prior to a ruling by the Second Circuit, CSX held its annual meeting of shareholders on June 25, 2008, and the result of the election of directors to CSX's board was "too close to call." The annual meeting of shareholders will reconvene on July 25, 2008 to certify the outcome of the shareholder vote, allowing the independent inspector of elections time to tabulate results of the annual vote. On July 17, 2008, CSX issued a press release stating that TCI and 3G had won election of four of their five nominees to CSX's board. CSX stated that the voting results "are subject to a customary review and challenge period as well as the outcome of pending litigation." The Second Circuit is scheduled to hear arguments on the appeal of the Southern District's ruling during the week of August 4, 2008. <

SEBI Guidelines

The Government of India maintains fairly extensive restrictions on investments in Indian securities by non-Indian investors. These restrictions include licensing programs under which specified types of non-Indian investors may obtain licenses to invest in certain classes of Indian securities. For example, regulated non-Indian institutions that meet specified conditions have been able to obtain licenses as "Foreign Institutional Investors" ("FIIs") to invest in securities listed on Indian stock exchanges. Non-Indian investors may also apply for a "Foreign Venture Capital Investor" ("FVCI") license to make venture capital and private equity investments on a more favorable basis than would otherwise apply.

At the end of May 2008, the Securities and Exchange Board of India ("SEBI"), which administers the FII licensing program, issued important new rules governing the program. A little background is helpful in order to put these new rules in proper context.

The FII licensing program was designed, among other things, to ensure that non-Indian investments into India are made by reputable, established investors so that India avoids "hot money" investments that generate rapid movements of capital into and out of India. Last year the SEBI grew increasingly concerned that the FII licensing program was not operating as effectively as possible. In particular, SEBI was concerned that "Offshore Derivative Instruments" ("ODIs"), such as participating notes, were being used to effectively circumvent the FII licensing program. For example, an international financial institution registered as an FII might on behalf of a non-Indian client acquire shares on an Indian stock exchange and then issue to the client an ODI that effectively transfers to the client the economic risks and rewards of those shares. As a result, in October 2007 SEBI announced several new restrictions on the issue of ODIs by FIIs.

These new restrictions created controversy, because many non-Indian hedge funds and other institutions had acquired substantial exposure to the Indian market through ODIs. The new restrictions made many financial institutions unwilling or unable to issue new ODIs or to renew ODIs that were previously issued. As a result, SEBI came under pressure to clarify the new restrictions and to liberalize the criteria for obtaining an FII license, so that more institutions could become FIIs and thus would not need to use ODIs in order to obtain exposure to the Indian securities markets. SEBI indicated that it would review its rules on FIIs and ODIs and provide some further clarification. While this clarification was initially expected in late 2007 or early 2008, SEBI did not issue it until the end of May 2008.

The new rules issued at the end of May have broadened the categories of non-Indian investors that may obtain FII licenses. For example, unregulated university endowments, pension plans and charitable organizations that serve the public interest may now obtain FII licenses. Further, a newly organized regulated/supervised investment fund may obtain an FII license without having the 12-month track record that SEBI generally requires for FII licenses by relying on the 12-month track records of their investment managers.

The new rules also clarified the types of non-Indian institutions to which FIIs may issue ODIs. For example, the new rules provide that a non-Indian institution is eligible to hold an ODI if it is either (a) regulated/supervised and licensed/registered by a non-Indian central bank or (b) registered and regulated by a securities or futures regulator in any non-Indian country or state. We understand that these new rules may mean, for example, that a fund registered with the Cayman Islands Monetary Authority may hold ODIs.

Bingham has a global funds practice. While we do not advise on Indian law, we do advise our fund clients on the non-Indian law aspects of investing in Indian listed securities, real estate and private equity. As a result of the global nature of our practice, Bingham has developed effective working relationships with many top-ranked Indian law firms that can advise our fund clients on specific Indian law matters, including the new SEBI rules. <

Deferred Fee and Bonus Arrangements

Fund managers should bear in mind that 2008 is the last "transition" year under Section 409A of the Internal Revenue Code. Section 409A, which came into effect at the beginning of 2005, dramatically changed the rules governing the taxation of nonqualified deferred compensation. It affects deferred fee arrangements between fund managers and the offshore funds they advise as well as deferred bonus arrangements between fund managers and their employees. While the statute does not limit the *amount* of fees and other compensation that may be deferred, it does impose restrictions on when compensation can be deferred, when the deferred compensation can be paid out and how it can be funded.

Final Section 409A regulations become effective on January 1, 2009. Until then, reasonable, good faith compliance with the statute is required. However, by that date, all fund managers must have analyzed their deferred compensation arrangements, restructured them where necessary and made any modifications to plan documents to bring them into compliance with the statute and its final regulations. Some very useful transition relief, which will also expire at the end of 2008, gives fund managers, their principals and employees considerable latitude in rescheduling payment dates for previously deferred compensation. After 2008, deferred compensation arrangements will be considerably less flexible.

Fund managers are strongly encouraged to finalize the review and amendment process as early as possible this year to give themselves ample time before the deadline to refine plan design and take full advantage of transitional relief. Managers should also be aware that the intense congressional scrutiny given during 2007 to fund manager compensation has not abated this year. Two recent legislative proposals would essentially put an end to long-term offshore hedge fund deferred fee arrangements for fees earned after 2008, and require deferred fees earned before 2009 to be taken into income no later than 2017. <

About Our Hedge Fund Practice

Bingham has an internationally recognized hedge fund practice that counsels a broad spectrum of hedge funds, funds of funds and other pooled investment vehicles, together with their manage-ment firms and investors, both in the United States and abroad. The practice is a key part of Bingham's Investment Management Practice Group and its Securities Area, which deploys over 120 lawyers serving a wide range of money managers and other financial services firms.

Our hedge fund lawyers draw on the experience of our other investment management lawyers as well as the wide array of legal resources available at our nearly 1,000 lawyer firm, including our Broker-Dealer, Securities Litigation and Corporate Governance practices and lawyers with experience in tax, ERISA, derivative transactions, SEC enforcement, financial restructuring and credit matters.

We have experience with all the major offshore fund domiciles, such as Bermuda, the British Virgin Islands, the Cayman Islands, Mauritius and the Netherlands Antilles. We also work closely with partners in our London, Hong Kong and Tokyo offices; lawyers from our international practice groups; and a well-established worldwide network of non-U.S. lawyers.

SEC Proposes Amendments to Regulation S-P to Enhance Safeguarding of Customer Information

INTRODUCTION

On March 4, 2008, the SEC voted unanimously to publish for public comment proposed amendments to Regulation S-P (the "Proposed Amendments") to enhance the protection of consumer financial information. The safeguards rules described below apply to brokers, dealers, registered investment advisers and investment companies. The disposal rules have the same applicability, but also apply to registered transfer agents. One of the Proposed Amendments is to expand the applicability of the safeguards rules to registered transfer agents. Please note that securities futures brokers that are registered by notice with the SEC under Section 15(b)(11) of the Securities Exchange Act of 1934, as amended, will be subject to the U.S. Commodity Futures Trading Commission's safeguards rule, not the SEC's safeguards rule.

SAFEGUARDS AND DISPOSAL RULES

The safeguards rule, Section 30(a) of Regulation S-P, currently requires financial institutions to adopt written policies and procedures to safeguard customer records and information. The safeguards are required to be reasonably designed to meet the objectives of the Gramm-Leach-Bliley Act ("GLBA"). The disposal rule, Section 30(b) of Regulation S-P, requires financial institutions to protect against the improper disposal of consumer report information. The SEC believes that due to the increasing number of security breaches, a review of these rules is warranted. The SEC has designed the Proposed Amendments to strengthen the safeguards and disposal rules in four ways, as detailed below.

EXPANDING THE SCOPE OF THE INFORMATION COVERED BY THE RULES

The Proposed Amendments would broaden the scope of the information covered by the safeguards and disposal rules to better protect against the unauthorized disclosure of the information. Currently, the safeguards rule requires financial institutions to have procedures to protect "customer records and information," a term not defined in Regulation S-P or in the GLBA. By contrast the disposal rule currently applies to the disposal of "consumer report information," which is a defined term in the Fair and Accurate Credit Transactions Act of 2003.

Accordingly, the SEC proposes to apply both rules to "personal information" and to define that term to include any record containing "nonpublic personal information" or "consumer report information." "Nonpublic personal information" means personally identifiable financial information and any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available information. "Consumer report information" means any record about an individual, whether in paper, electronic or other form, that is a consumer report or is derived from a consumer report as well as a compilation of such records, but not including information that does not identify individuals such as aggregate information or blind data. In addition, the proposal further expands the scope of "personal information" to include information identified with any consumer, or with any employee, investor or securityholder who is a natural person, in paper, electronic or other form, that is handled by the financial institution or maintained on the institution's behalf. The SEC seeks comment on whether this definition should be expanded further, but does not question whether it is overly broad. Commenters should take care to evaluate whether this definition is too broad and if such a definition would make implementation impracticable or would impose undue expense.

APPLYING THE DISPOSAL RULE TO INDIVIDUALS

The SEC is proposing to extend the disposal rule to apply to natural persons who are associated persons of a broker-dealer, supervised persons of a registered investment adviser and associated persons of a registered transfer agent. The SEC has stated that the Proposed Amendments would "make persons associated with a covered institution directly responsible for properly disposing of personal information consistent with the institution's policies." The SEC seeks comment on whether there are alternative ways to ensure that associated persons and supervised persons comply with a firm's policies on disposal of information.

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SEC PROPOSES AMENDMENTS CONTINUED FROM PAGE 5

MORE DETAILED STANDARDS FOR SAFEGUARDING INFORMATION

The Proposed Amendments would establish a framework for the safeguarding of consumer financial information modeled after that used by federal banking agencies and the Federal Trade Commission. The intent of the Proposed Amendments is to provide firms with the flexibility necessary to tailor policies and procedures to their size and the nature of their business. The SEC believes that the Proposed Amendments codify best practices that many firms already have implemented with respect to protecting consumer data.

Financial institutions would be required to establish a comprehensive information security program that would consist of detailed written policies and procedures to address administrative, technical and physical safeguards for protecting consumers' nonpublic personal information. The procedures would have to cover foreseeable security risks that could result in unauthorized access to or use of information and identify the safeguards the firm has implemented to control the identified risks.

The procedures would need to be designed to protect against unauthorized access to or use of personal information that could result in substantial harm or inconvenience to any consumer, employee, investor or securityholder who is a natural person. The proposed definition of "substantial harm or inconvenience" would include a harm that can cause personal injury or more than trivial financial loss, expenditure of effort or loss of time, and would include, among other things, theft, fraud, intimidation, damaged reputation and impaired eligibility for credit. As the proposed definition of "substantial harm or inconvenience" is not intended to include unintentional access to personal information that results in trivial losses, the Proposed Amendments would include an example of insubstantial harm or inconvenience to clarify the definition's scope.

The key security controls of the information security program would need to be tested and monitored. The effectiveness of the controls, as well as the testing and monitoring program, would have to be documented in writing. The information security program would need to be modified, as appropriate, to reflect the results of the testing and monitoring as well as relevant technology enhancements and other changes that could impact the program. Although the Proposed Amendments do not indicate how often the testing must occur, a footnote suggests that for investment advisers and investment companies subject to Rule 206(4)-7 under the Investment Advisers Act and Rule 38a-1 under the Investment Company Act, the testing should be at least annual. While there is no reference in the footnote to broker-dealers, because broker-dealers are subject to NASD Rule 3012 that requires annual testing of a firm's procedures, it can be assumed that the safeguard procedures should be tested at least annually for broker-dealers as well.

These financial institutions would be required to designate one or more individuals responsible for the information security program. The designated individual(s) would be responsible for reviewing, maintaining and enforcing the firm's information security program. Firms would also be required to establish procedures to oversee any service providers to ensure that they, too, maintain appropriate safeguards for customer information.

MORE DETAILED STANDARDS FOR RESPONDING TO DATA SECURITY BREACHES

Financial institutions would be required to establish written procedures that address how the firm will assess any data security breach and the steps to contain and investigate the breach.

In addition, firms would need to establish procedures to provide prompt notice to affected individuals if a data security breach has occurred or is reasonably possible. The SEC did not provide guidance on what is meant by "reasonably possible" but is seeking comment to determine if this threshold for notice is appropriate or whether there should be an alternative threshold for notice. The SEC indicated that it did not want to trigger notice "in every instance of unauthorized access or use, such as if an employee accidentally opened and quickly closed an electronic account record," because otherwise "individuals could receive an excessive number of data breach notifications and become desensitized to incidents that pose a real risk of identity theft."

If a data security breach results in substantial harm or inconvenience to an individual or an unauthorized person has intentionally obtained access to or used sensitive personal information, notice would also need to be provided to the SEC (or, for certain broker-dealers, their designated examining authority). The SEC believes this trigger for regulatory notice will conserve "administrative resources by allowing minor incidents to be addressed in a way that is commensurate with the risk they present." <

The full proposal is available at the following link:
www.sec.gov/rules/proposed/2008/34-57427.pdf

Japanese Private Placements

On September 30, 2007, Japan enacted the Financial Instruments and Exchange Law (the "FIEL"), a new securities law replacing the Securities and Exchange Law. The FIEL sets out new rules, among them an exemption, under certain circumstances, from the obligation to file a securities registration statement (a "SRS") with the Financial Services Agency when an entity issues securities to raise money.

The FIEL divides securities into two categories for purposes of the SRS filing requirement: (i) a high-liquidity security such as a stock share, a bond or a mutual fund trust unit and (ii) a low-liquidity security, such as a limited liability company interest or a limited partnership interest, which are generally not listed on Japanese exchanges. Generally, an SRS must be filed for securities falling into category (i) and not for securities falling into category (ii).

The FIEL provides two kinds of exemptions from the SRS filing requirement for securities designated in category (i) above. The "professional private placement" exemption can be used by an issuer when it offers newly issued securities only to "qualified institutional investors" (defined in the relevant cabinet office ordinance to include banks, insurance companies, securities firms, investment managers and mutual funds), and it is unlikely that the acquirer will transfer the securities to a non-"qualified institutional investor." For instance, if a nonpublic corporation offers its newly issued shares only to "qualified institutional investors" and each offer is made with such condition that the acquirer will be prohibited from transferring the shares to any non-"qualified institutional investor," the issuer will be relieved of its SRS filing requirement.

The second exemption is the "small number private placement" exemption, which is applied to offerings in which the newly issued security is offered to 49 or fewer people, and it is unlikely that the securities will be transferred from the acquirer(s) to a large number of people (for instance, a stock share of a nonpublic company is deemed to be such type of security under the FIEL). In relation to the calculation of the number of people, the number of offers made to persons falling within the "professional private placement" exemption can be excluded. On the other hand, the number of people having been offered the same kind of securities in the past six months has to be included.

Generally, the FIEL does not impose the SRS filing requirement on an issuer for securities falling into category (ii) above, although there are some exceptions. One such exception to the exclusion from filing is the case where (a) an issuer is an investment vehicle organized (or to be organized) with the purpose of investing more than 50 percent of its assets in securities, (b) the number of people who will acquire units of the investment vehicle (in this calculation "qualified institutional investors" have to be taken into account) is 500 or more and (c) the amount of funds to be raised in issuing new vehicle units is 100 million yen or more.

The SRS filing requirement and the exemption provisions explained above may be applied to a non-Japanese issuer as well. In this connection, the FSA states "if offers are made inside Japan, these offers have to be taken into consideration, regardless of whether the offerees are Japanese residents or not. Also, offers which are made outside Japan to Japanese residents might have to be taken into account. However, if offers are made outside Japan to non-Japanese residents, these offers need not to be taken into account, in principle.<

About Our Securities Area

Bingham is a global law firm with nearly 1,000 lawyers in 13 offices spanning the United States and abroad. Our premier Securities Area provides clients with a fully integrated set of legal services focused on securities law and regulation. We serve the legal needs of U.S. and non-U.S. hedge fund, mutual fund and private equity fund clients, as well as other investment managers, broker-dealers and other financial services organizations, across a broad spectrum of sophisticated regulatory, compliance, complex financial transaction, litigation, enforcement and counseling matters.

Members of the Securities Area include seasoned legal practitioners in our Investment Management, Broker-Dealer and Securities Litigation practice groups as well as alumni of the U.S. Securities and Exchange Commission (SEC), the U.K. Financial Services Authority (FSA) and the Japanese Financial Services Agency.

Our commitment to all of our securities industry clients is to provide legal representation that is full-integrated, cost-efficient and focused on driving matters to successful conclusions.

Raising Permanent Capital in Europe: Easing the Process

INTRODUCTION

Certain types of investment funds whose investments are longer term or illiquid are increasingly looking at alternative ways of raising capital in Europe without imposing long lock-ups on investors. Closed-end investment funds that are listed on a stock market, and which therefore provide a trading facility for investors to exit should they wish to do so, are an increasingly attractive proposition for such investment funds looking to raise capital.

The requirements for listing investment funds on the main market of the London Stock Exchange ("LSE") contained in Chapter 15 of the LSE Listing Rules have been substantially modified (and relaxed) by two sets of amendments to the U.K.'s Listing Rules in September 2007 and March 2008. At the same time the option of a "directive minimum" listing on the main market of the LSE has been removed. This article considers the effect of these amendments and briefly reviews the principal options for listing investment funds in the E.U.

The starting position for an investment fund seeking to list on a regulated market (i.e., the main market of the LSE or Euronext), or on an unregulated market (i.e., AIM) but making an offer to the public, is that it must prepare an approved prospectus containing specified information. Once admitted to listing, the investment fund must comply with the reporting and disclosure requirements under the Transparency Directive (the "Disclosure and Transparency Rules"). These are referred to as the "directive minimum" requirements and the requirements that an investment fund with a listing on Euronext must follow. Additional requirements apply for listing on the main market of the LSE ("gold plating").

Alternatively, a quotation on AIM is an option for a closed-end investment fund, but not for any other type of investment fund. As AIM is an unregulated market, an investment fund seeking admission to AIM is not required to publish a prospectus unless it makes an offer to the public (although it must publish an admission document that is substantially equivalent) and is not subject to the Disclosure and Transparency Rules.

PRINCIPLES-BASED REGULATION

Listing on the main market of the LSE is based on principles-based regulation, relying on the six listing principles together with less detailed Listing Rules. There is an emphasis on "event-based" disclosure, allowing investors to make informed decisions on the basis of material information disclosed.

Event-based disclosure may pose logistical problems for certain investment funds. Essentially it provides that any information that may have a significant (which is not defined) effect on the share price must be immediately disclosed to the market and may not be selectively disclosed to certain investors. If the investment manager also runs traditional open-end investment funds with equivalent or very similar investment policies it will need to ensure that investors in such other investment funds do not obtain price sensitive information that is directly or indirectly referable to the listed investment fund ahead of the market generally (and so enable such investors to gain a potential dealing advantage).

INVESTMENT POLICY

The key eligibility requirement under the new Chapter 15 is that the investment fund must "invest and manage its assets in a way which is consistent with its object of spreading investment risk." This means that an investment fund with a single investment strategy may not qualify for listing on the main market of the LSE.

The investment fund must have a published investment policy that contains detailed information about the policies it will follow relating to asset allocation, risk diversification and gearing, including maximum exposures. The prior approval of the majority shareholders must be obtained to make any material change to that published investment policy, and the investment fund must at all times invest and manage its assets in a manner that is consistent with its object of spreading investment risk and in accordance with that published investment policy.

KEY CHANGES TO CHAPTER 15

Control of Investee Companies

There is now no restriction on an investment fund taking a controlling stake in an investee company, but cross-financing between portfolio companies and the operation of common treasury functions between the investment fund and investee companies are prohibited.

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20 Percent Restriction

The investment limit of 20 percent of consolidated assets in any single company or group at the time the investment is made has been removed.

Income, Surpluses and Dividends

The rule that dividends cannot be paid unless covered by income from underlying investments has been removed, thus allowing investment funds to smooth uneven income flow while still paying regular dividends. In addition, the prohibition on the distribution, as dividend, of surpluses arising from the realization of investments has been removed.

Feeder Funds

Previously, in order to list on the LSE, feeder funds were required to control the master fund's investment policy, which in many cases was impractical. Chapter 15 now provides for the spreading of investment risk as a key principle of the LSE's principles-based regulation. It is now a requirement for the feeder fund to ensure that the master fund's investment policy is consistent with the feeder fund's published investment policy, and the feeder fund will see whether the master fund in fact manages its investments in a consistent manner. This is not intended to require that the feeder fund be able to control or direct the master fund, but if it becomes aware that the master fund is not so investing or managing its investments, the feeder fund will need to consider whether it should withdraw its funds from the master fund to avoid being in breach of the Listing Rules.

Related Parties and Co-Investment

The related-party requirements (that require independent shareholder approval of transactions (other than *de minimis* transactions) with the investment fund's investment manager) no longer apply to an arrangement between an investment fund and its investment manager where the arrangement is such that each invests and provides finance to an investee company and the investment or provision of financing is made either at the same time and on the same terms or in accordance with a pre-existing agreement between the investment fund and its investment manager. Investment by an investment fund in another investment fund managed either by its investment manager or a group company of the investment manager is not considered to be a related-party transaction in the absence of accompanying "arrangements" between the investment manager and the investment fund.

KEY CONTINUING REQUIREMENTS

Board Independence From Manager

The basic requirement is that the board or equivalent body of an investment fund must be able to act independently of the investment manager. Specifically this means that a majority of the board, including the chairman, must not be:

(i) directors, employees, partners, officers or professional advisers of the investment manager or any other company in the same group as the investment manager; or

(ii) directors, employees or professional advisers of other investment funds that are managed by the same investment manager or by any other company in the same group as the investment manager.

Shareholder Votes

The requirement for shareholder approval for non-preemptive issues of new shares/units for cash at a price below net asset value remains.

Equality of Treatment

It is a fundamental principle of the Listing Rules for the main market of the LSE that shareholders of the same class are treated equally. This effectively rules out differential fee arrangements (although in practice incentive fees for major subscribers and/or trail fees for significant continuing investors are permitted) and certain other provisions commonly covered by side letters. While different classes of holders could be treated differently, the requirement that 25 percent of each class is in public hands may make this more difficult to achieve.

AIM

A number of investment funds have listed on AIM, which is neither a regulated market nor a recognized stock exchange. Even where no public offer is made, in practice, the admission document includes information equivalent to that of a prospectus.

EURONEXT

Euronext is a regulated market and a recognized stock exchange and Euronext Amsterdam has been the venue of a number of private equity and hedge fund listings. The Euronext Rule Book contains few continuing obligations

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RAISING PERMANENT CAPITAL CONTINUED FROM PAGE 9

other than in relation to the requirement that the securities are fairly negotiable and for prior notification of corporate actions.

NATURE OF THE FUND

Official List

Under the new Chapter 15, any investment fund that is an undertaking with limited liability, including a company, limited partnership or limited liability partnership, and whose primary objective is investing and managing its assets in property of any description with a view to spreading investment risk, is eligible for listing. Partnership units are not currently admissible to CREST and one of the requirements for admission to any of the markets described is eligibility for electronic settlement. However, Clearstream does admit partnership units. Offshore investment funds should note that pre-emption rights are required to be included in their articles if they want to be included in the FTSE UK Index Series.

Euronext

Euronext has accepted for listing units in limited partnerships and units in FCPs as well as shares in closed-end investment funds.

AIM

AIM is not willing to admit any vehicle other than a limited company.

WHICH MARKET?

The choice of market for an investment fund will depend on a range of factors, including:

- Requirements for entry: Euronext and AIM are significantly more liberal
- Investor requirements: for certain investors, shares listed on an unregulated market (i.e., AIM) may be significantly less attractive or not permissible
- Ongoing obligations: the main market of the LSE has significantly more onerous continuing obligations
- Liquidity of market: there is little doubt that the main market of the LSE is more liquid than the others, making it easier for investors to buy/sell
- Depth of capital: the pool of capital available on the main market of the LSE is generally thought of as much greater
- Geographical investor base: AIM is far more domestic than the other markets

Bingham has represented numerous funds, investment managers, sponsors and placing agents in connection with listing closed-end funds. We currently represent approximately half of the London-listed fund of hedge funds market (by market capitalization) including the world's largest exchange-traded fund of hedge funds. <

Making IFRS the Global Accounting Standards

On May 28, 2008, SEC Chairman Christopher Cox spoke at the 33rd Annual Conference of the International Organization of Securities held in Paris, France. In his address, Chairman Cox tackled the issue of establishing global accounting standards based on the International Financial Reporting Standards (the "IFRS"). According to Chairman Cox, the promise of global standards is truly remarkable because it would improve investor confidence as a result of increased disclosure and transparency as well as enable investors to more easily compare issuers' disclosures from different countries and better evaluate investment opportunities in competing markets. Although recognizing that it might be a very long time before any spoken language achieves the status of a true *lingua franca*, Chairman Cox was far more optimistic about the possibility of a *lingua franca* for accounting in the near future. Nearly 100 countries around the world currently require or permit the use of IFRS and many more countries are poised to do the same. Chairman Cox laid out five principles described below that he considers critical for the success of IFRS as the global accounting standards and charged the securities regulators at the conference with the task of ensuring that the principles are applied.

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INVESTOR INTEREST IS PARAMOUNT

Although a large number of people rely on financial statements for reasons ranging from making business decisions to aggregating and analyzing industry statistics, the investors' interests are paramount in an accounting standard setting, according to Chairman Cox. He explained that because a public company's financial reports are a direct communication between the company and its investors, the accounting standards should be crafted to promote clarity and comparability for investors. Chairman Cox further stressed the importance of putting investors' interests at the forefront as the International Accounting Standards Board (the "IASB") reviews the IFRS in the wake of the recent market turmoil.

Pointing to the International Accounting Standards Committee (the "IASC") Foundation's aggressive support for eXtensible Business Reporting Language ("XBRL"), a standards-based language for financial reporting, Chairman Cox predicted that different spoken languages will eventually be embedded in XBRL data tags attached to public company financial statements. This move would allow any investor to read an IFRS financial statement from any country in his or her own native language, Chairman Cox explained.

STANDARD-SETTING PROCESS MUST BE TRANSPARENT

According to Chairman Cox, transparency in the standard-setting process is essential for both maintaining investor confidence and ensuring high-quality standards. This means that a standard-setting process should, at a minimum, have input from all affected parties such as investors, preparers, auditors, regulators and intermediaries. The IASB, Chairman Cox noted, has implemented procedures regarding the selection of agenda items, public meetings, working groups and public requests for comment to encourage transparency throughout the standard-setting process.

STANDARD SETTER MUST BE INDEPENDENT

Chairman Cox stressed the need for the global standard setter to remain free from political, financial and corporate pressures. It appears, for the most part, that the IASB and its governing body, the IASC Foundation, have managed to do just that. The IASC Foundation, according to Chairman Cox, continues to increase its funding from independent sources and now receives levies or national payments from several countries. Chairman Cox further stated that the IASB, whose members are appointed by the IASC Foundation, does not have a practice of selecting members to represent specific national interests or political constituencies.

STANDARD SETTER MUST BE ACCOUNTABLE

Chairman Cox expects a global accounting standard setter to be accountable for timely maintenance of standards, transparency in standard setting and fidelity to investor interests. Chairman Cox pointed out that national authorities that have invested their confidence in the IASB's standard-setting process have the right to insist that the IASB does in fact establish a common and transparent accounting language. The IASC Foundation, according to Chairman Cox, is dedicated to the development of a single set of standards that are understandable and enforceable. To support this statement, Chairman Cox cited the Constitution of the IASC Foundation, which has a public interest mandate, the requirement that all trustees of the IASC Foundation formally commit to acting in the public interest, and the IASC Foundation's intention to create a new monitoring group as part of its 2008 Constitution review.

STAKEHOLDERS SHOULD PARTICIPATE IN THE STANDARD-SETTING PROCESS

Chairman Cox implored all authorities responsible for financial reporting to continue discussing the development of IFRS and promote its consistent application. An ongoing dialogue among issuers, auditors, standard setters and regulators is critical, as Chairman Cox explained, particularly because IFRS is still relatively new to many. Chairman Cox warned that cooperation among stakeholders is required to protect against the "incipient tendency" toward a divergent set of IFRS across jurisdictions. Regulators, Chairman Cox noted, have already begun to engage in the necessary dialogue through the International Organization of Securities Commissions database, but he cautioned that a sustained effort is needed to ensure that IFRS are developed, interpreted and applied consistently. <

Click this link for the full text of Chairman Cox's speech: http://www.sec.gov/news/speech/2008/spch052808cc.htm

SEC Liberalizes Rules 144 and 145

At its November 15, 2007 meeting, the SEC unanimously voted to adopt substantially as proposed certain proposals aimed at reducing regulatory burdens to capital raising and reporting. The new rules include the most significant amendments to Rule 144 in over 10 years and changes to Rule 145, both of which apply to companies of all sizes.

SHORTENING HOLDING PERIODS FOR RESTRICTED SECURITIES; RULE 144/145 CHANGES

Rule 144 is the principal "safe harbor" exemption from registration under the Securities Act for resales of "restricted securities," that is, shares sold under Regulation D or another exemption available to issuers. Among the conditions of Rule 144 was a minimum one-year holding period for restricted securities. The new rules amend Rule 144 to:

- Shorten the holding period for restricted securities of SEC-reporting companies from one year to six months (but maintain the one-year holding period for private company securities);
- Eliminate all restrictions other than the "current public information" requirement for restricted securities held by non-affiliates of reporting companies after six months, and eliminate all restrictions for restricted securities held by non-affiliates of all companies after one year. For non-affiliates of reporting companies, this change would nearly amount to shortening the current Rule 144(k) "free stock" holding period from two years to six months. Sales would still be barred, however, at any time during the second six months during which the issuer was late in filing an SEC report;
- Raise the Form 144 *de minimis* filing threshold for affiliates (who alone will be required to file the form) to 5,000 shares or $50,000 (whichever is lower);
- Revise the manner of sale requirements for equity securities and eliminate them for debt securities; and
- Simplify and streamline portions of Rule 144 and codify certain staff interpretations under the rule, including certain interpretations regarding the tacking of holding periods upon the cashless exercise of an option or warrant.

The SEC chose *not* to (i) adopt its proposal to suspend the running of ("toll") the holding period for restricted securities of reporting companies for up to six months if the holder engages in certain hedging transactions, out of concern that the change would unnecessarily complicate Rule 144, or (ii) allow Section 16 insiders to satisfy their Form 144 filing requirements through their Form 4 filing (though the SEC stated that it will continue to consider this issue).

With respect to Rule 145, the SEC adopted its proposal to eliminate the restrictions on resale that currently apply to affiliates of a target company who receive stock in a merger registered on Form S-4, except that restrictions would be retained for affiliates of blank check or shell companies that engage in such a merger.

The changes to Rules 144 and 145 took effect on February 15, 2008 and will apply to securities whenever acquired, including retroactively to securities acquired before that date. <

On the Calendar

Partners from Bingham's Investment Management Practice Group and its securities-related practices often speak at industry conferences and in-house seminars. If you would like to learn more about any of the following programs, please e-mail patricia.palmer@bingham.com.

- **Hedge Funds 101 and 102** (New York), September 24–25, 2008. Robert G. Leonard. Presented by Financial Research Associates, LLC. www.frallc.com
- **NSCP—National Membership Meeting** (Philadelphia), October 20–22, 2008. Jeanie Cogill, Steven W. Hansen and Steven R. Howard. Presented by the National Society of Compliance Professionals. www.nscp.org

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