hedge media guide to listing

Alternative Investment Funds

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UK & Channel Islands
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Introduction

The Hedgemedia Guide to Listing Alternative Investment Funds is a unique online publication that is being made available to the 50,000-strong global hedge funds, real estate and private equity managers and service providers that read Hedgeweek and its family of alternative investment newsletters.

The focus of the Guide is to help managers, promoters and their advisers decide where best to list their alternative investment funds, and is intended to complement the Guide to Setting-up Alternative Investment Funds, issued earlier this year.

Taken together, these series of Guides cover all the major current rules and regulations covering the establishment and listing of alternative investment funds in a comprehensive treatment of the subject covering the major jurisdictions globally.

The first part of this Guide to Listing Alternative Investment Funds focuses on the UK and the Channel Islands and includes an overview on listing alternative investment funds in each jurisdiction, provided by the key exchanges.

We would like to thank Tamara Menteshvili, Chief Executive of the Channel Islands Stock Exchange and Andrew Wallace, Senior Manager, Specialist Fund Market at the London Stock Exchange, for their invaluable time and assistance in preparing a comprehensive overview of each exchange in this first edition.

We look forward to your feedback and your participation in forthcoming regional extensions of this Guide.

Sunil Gopalan
Editor-in-Chief
Hedgemedia Ltd
The Specialist Fund Market is the London Stock Exchange’s dedicated market for specialist investment funds targeting institutional, professional and highly knowledgeable investors.

Aimed exclusively at the growing number of specialist funds, the Specialist Fund Market is designed specifically for the needs of sophisticated investment fund structures and their expert investors.

To find out more about the Specialist Fund Market and the opportunities for investment and capital raising, please visit our website or call us on +44 (0)20 7797 1696.

Make your move on the Specialist Fund Market.

www.londonstockexchange.com/specialistfundmarket
Why float, why London?
The alternative investment fund industry has traditionally operated in the private space, but as the industry matures, and the demand for access from a wider investor base increases, achieving economies of scale through the private fund structure can prove difficult for all but the very biggest players. As a private fund manager, how do you increase your profile to a wider, global investor base? How do you demonstrate the public track record and appropriate levels of disclosure and transparency that are part and parcel of an institutional investor’s due diligence process? And how do you encourage secondary market liquidity to enable your wider investor base to trade their stakes? One route to accessing economies of scale is for closed-ended funds to seek admission to trading on an ‘effective’ public capital market.

There are a number of tests that help to define what constitutes an ‘effective’ capital market. For instance, it should operate at the centre of a cluster of specialist advisers, investors and administrators. It should facilitate access to significant capital pools. It should carry a respected brand, helping to create global profile. And of course, it should offer a robust trading service to facilitate secondary market activity.

London certainly satisfies the ‘cluster’ test, sitting in a time zone spanning the global business day, with its wealth of specialist advisers, an extensive global banking community and a principles-based regulatory regime. London has quickly become one of the most important locations outside the US for alternative managers and is by far the dominant centre in Europe. Indeed, London’s share of global hedge fund assets alone accounts for some 20 per cent of the world total and 90 per cent of European hedge fund managers now make London their home.

Within that environment, the London Stock Exchange passes the remaining tests, offering a choice of markets that open access to Europe’s largest capital pool, the instant recognition of the London Stock Exchange’s globally trusted brand and a cutting-edge trading system to facilitate liquidity. The Exchange has a long pedigree in the quoted funds arena: closed-ended funds have been admitted to its markets for over 70 years. Currently, the Exchange hosts over 571 funds capitalised at $166 billion.

Choice of markets
No two alternative funds are the same. Each will have differing levels of sophistication, in terms of the investment remit, the fund structure, the method of participation, and the investor audience sought. It is essential to cater for this diversity, which is why the Exchange offers three markets for closed-ended funds: the Main Market, the Specialist Fund Market and AIM. Whilst AIM is the Exchange’s international market for smaller growing companies and is suitable for more straightforward funds seeking a broad investment audience, the two principal markets for alternative fund managers are the Main Market and the Specialist Fund Market.
The Main Market
Regulated by the UK’s Financial Services Authority (FSA), the Main Market is the Exchange’s flagship global market for trading companies and investment entities. The Main Market has EU Regulated Market status, being ‘MiFID compliant’. Closed-ended funds must not only meet European standards of disclosure and transparency, enshrined in the Prospectus, Transparency and Market Abuse Directives, but must also qualify for a ‘Listing’ by complying with Chapter 15 of the FSA’s Listing Rules, which sit over and above – or are ‘super-equivalent’ – to the European framework.

For funds admitted to the Main Market, it is this combination of European law and supplemental Listing Rules that opens up access to the widest possible investor base from sophisticated institutional to a broad range of retail investors.

In particular, listed, Main Market funds benefit from potential inclusion in the FTSE UK Index Series on which tracker and benchmarked funds are built. They also qualify as permitted investments within general retail tax wrappers in the UK such as Individual Savings Accounts (ISAs) and Self-Invested Personal Pension plans (SIPPs). These are a significant part of what is Europe’s largest capital pool. For instance, tracker and benchmarked funds comprise over $300 billion\(^3\) of assets, whilst there are over 12 million retail ISA accounts worth $145 billion\(^4\).

For funds seeking to develop and manage property, a listing on the Main Market is also a pre-requisite for applying to the UK tax authorities for recognition as a ‘UK-REIT’, conferring various tax benefits.

The Specialist Fund Market
However, not all funds will be seeking to appeal to general retail investors. The more complex funds wishing to create a permanent capital base from experienced, professional investors may require a more flexible market structure. Opened in November 2007 as a peer group market for alternative investment funds and their associated investors, the Specialist Fund Market appeals to hedge funds, private equity funds, emerging country and specialist property funds. The market is also capable of accepting more complex structures, governance models and security types. Limited partnerships, non-voting shares, and funds with concentrated investment policies and bespoke governance arrangements can be accommodated.

As with the Main Market, the Specialist Fund Market is regulated by the FSA, and has EU Regulated Market status. However, unlike the Main Market, funds do not have to comply with the FSA’s Listing Rules, which pre-suppose general retail investor participation and are not applicable for funds wishing to appeal only to a more sophisticated, predominantly institutional, investor base.

Importantly, EU Regulated Market status is the baseline requirement for access to European institutional investment mandates without being subject to threshold limits. Specialist Fund Market securities are eligible for inclusion in occupational pension funds, insurance funds and even other mutual funds such as UCITS.

Admission requirements
For a closed-ended fund, admission to the Main Market or the Specialist Fund Market requires the production of an EU Prospectus Directive compliant document approved by an EU Competent Authority. In the UK this is the FSA. Key requirements for disclosure in such a prospectus include:

- a detailed description of the investment objective and policy
• details of any investment restrictions which apply
• information on the investment manager and other advisers to the fund
• details of custody, trustee and fiduciary arrangements
• valuation principles and the frequency and method for determining NAV
• details of cross liabilities
• relevant financial information
• a comprehensive and meaningful analysis of the fund’s portfolio.

Funds seeking admission to the Main Market must also comply with the FSA Listing Rules, which include the requirement for a minimum of 25% of shares to be in public hands and the appointment of an FSA-approved ‘Sponsor’ (normally a bank or corporate finance house). The fund must also show that it will invest and manage its assets in a way which is consistent with its objective of spreading investment risk and it must also ensure that the board acts independently of the investment manager.

Any EU Competent Authority can approve a prospectus, which can then be ‘passported in’ to the UK for admission to either the Main Market or the Specialist Fund Market. However, a fund wishing to be passported in to the Main Market will have to prove that it also complies with the additional Listing Rules. Equally, a prospectus approved in the UK by the FSA can be passported to other European capital markets.

As well as meeting the requirements of the FSA, the Exchange maintains an obligation to maintain a fair, orderly and transparent market. Applicants for either the Main Market or the Specialist Fund Market must therefore also comply with the Exchange’s Admission and Disclosure Standards. Given the sophisticated nature of the market, Specialist Fund Market applicants in particular will need to ensure that they can show adequate free float and that securities will be freely transferable and negotiable.

Other considerations
There is no restriction on domicile for funds seeking admission to either the Main Market or Specialist Fund Market, the choice of which will be directed by tax and other considerations. And unlike other jurisdictions and markets (such as the ‘144a market’ in the US), there is also no differentiation for certain types or size of investor. Instead, it is the responsibility of the agency network (e.g. stockbrokers) to assess investor suitability. In the UK, agents are bound by, amongst other things, the FSA’s Conduct of Business rules, but local rules will apply in the jurisdiction concerned if that is not the UK.

The timescale for the production and approval of a prospectus can vary, but a minimum of three months should be considered. An FSA-approved Sponsor must be appointed for a Main Market float and they will manage the application process, whereas the lawyer or corporate finance house/broker is more likely to take the lead role in shepherding a Specialist Fund Market application. The provision of financial information is an important consideration for existing funds seeking to float and so the role of the reporting accountant is crucial.

Flotation costs will vary and are a factor of time and complexity of the proposition involved. Whichever market is selected, applicants must be prepared to dedicate time, effort and resource to ensure the process proceeds smoothly and cost effectively. This extends to developing proactive relationships with administrators and ensuring that effective investor and public relations functions are created either internally or in partnership with agencies that specialise in the funds world. Managers seeking to extend investor interest further will need to consider either corporate broking or placement agent involvement in the book-building exercise.

Ongoing requirements
Ongoing obligations for both the Main Market and the Specialist Fund Market also reference European law – chiefly the EU’s Market Abuse and Transparency Directives – as applied through the FSA’s Disclosure and Transparency Rules. For both markets, new issuers will (amongst other things) need to:
• produce annual and half-yearly reports and interim management statements (with financials to IFRS or equivalent for non-UK applicants)
• identify and disclose inside information, maintaining an Insiders’ List of those who may have access to such information
• compile an Annual Information Update which includes or refers to all regulatory information filed or reported to the market. However, Main Market funds must also abide by ‘super-equivalent’ disclosure and transparency obligations under the Listing Rules, including requirements to:
  • incorporate the UK’s Combined Code on Corporate Governance, which covers the composition and operation of the board and sub-committees, and topics such as directors’ remuneration, relationships with shareholders, supply of information to the market and accountability and audit measures;
  • comply with the Model Code, restricting directors’ dealings and buybacks during a close period;
  • in certain circumstances seek prior shareholder approval and/or provide notice for certain transactions through the application of pre-emption rights and by observing the FSA’s Significant Transactions or ‘Class Tests’ regime;
  • seek shareholder consent for a material change in investment policy;
  • comply with the ‘related party transaction’ rules, applying to transactions and arrangements with those capable of exercising significant influence;
  • appoint an FSA-approved Sponsor for certain transactions;
  • ensure that the majority of the board of directors (including the Chairman) remain independent of the investment manager;
  • ensure that feeder fund investments are consistent with the master fund’s investment policy.

Main Market or Specialist Fund Market
The choice between a float on the Main Market or Specialist Fund Market is a subjective and highly individual one. For funds looking to appeal to the widest investor base and content to comply with the additional disclosure and transparency requirements this entails, the Main Market will be the ideal route. However, sophisticated or specialised funds requiring more flexibility in approach when it comes to accommodating particular structural characteristics may find the Specialist Fund Market a more appropriate route.

Summary
Despite the dramatic market conditions experienced of late, demographics dictate that the alternative funds industry will continue to be in demand over the long term. There are now nearly 600 million people in the world aged over 60 years – a figure expected to double in the next twenty years. With people living longer, traditional institutional investors such as pension and life funds increasingly have to make their assets work harder for longer. It is likely that investor demand for alternative funds offering the discipline, appropriate disclosures and secondary market potential that the public capital markets bring will also increase. And London, with its collaborative financial community and a choice of appropriate capital markets will continue to play a central role in meeting that demand.

Further information:
www.londonstockexchange.com/mainmarket; www.londonstockexchange.com/specialistfundmarket

Footnotes:
1. IFSL Research: Hedge Funds, 2008
2. Exchange figures to 30 September 2008
3. London Stock Exchange research sourced from Trustnet.com and individual fund manager and third party websites
4. IMA; April 2008
5. HSBC/OIA study, 2005
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P.O. Box 623, One Lefebvre Street, St Peter Port, Guernsey GY1 4PJ
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www.cisx.com
The Channel Islands Stock Exchange (CISX), which this year is celebrating its tenth anniversary, has become firmly established in the international marketplace and attracts business from many of the major regions of the world. There are 25 countries represented on the Official List and more than 200 international issuers have chosen the CISX as the launch pad for the primary listing and the trading of their securities.

To date, the Market Authority has admitted over 2900 securities to the Official List, with a market capitalisation in excess of USD50 billion (excluding capital markets products) as at September 2008.

The Exchange now occupies a significant position in the financial services sector of the Channel Islands, completing the range of services offered by financial services professionals and attracting new business to the Islands.

The CISX’s trademark high standard of personal service, delivered efficiently and pragmatically, has gained the CISX acceptance from an ever-increasing number of international issuers. At the same time, the Exchange’s disclosure regime and credible track record has enabled it to obtain recognition from regulatory authorities in some of the world’s leading economies.

Founded in October 1998, the CISX is in a unique position being outside the European Union, but within the strategic European time zone, and with the added benefit of widely-held international recognition. A key period was between 2002 and 2003 when the Exchange was recognised formally by the US Securities Exchange Commission and by Her Majesty’s Revenue and Customs (HMRC) in the UK. Within 12 months, it had also been approved as an Affiliate Member of IOSCO.

**Innovation**

The Market Authority understands the need for differentiation and innovation in a competitive marketplace and is well placed to meet the challenges of a demanding and diverse universe of product providers. It is willing to work with each issuer to see how their product structure might fit into the Exchange’s Listing Rules and, then, how the Exchange might bring added value to the listing.

For instance, long before the recent boom that boosted the profile of private equity investment around the world, the Channel Islands Stock Exchange was a pioneer in the field – it was one of the first stock exchanges in Europe to allow the listing of limited partnerships’ interests. Today the CISX has a number of these listings, particularly from the Scandinavian region, where this type of structure has been used by pension funds to invest in asset classes such as property and mezzanine financing. The Exchange has developed a significant role in providing a tax efficient means for raising debt for the UK private equity market. Over the past four years, issuers in England and Wales have been responsible for more than GBP30 billion in debt listings on the CISX.

In terms of the range of securities listed on the CISX, there is a very broad base, with niche markets in the listing of structured products, acquisition vehicles and property funds. The CISX is also widely used for the listing of a range of alternative fund structures, including property and hedge,
as well as private equity funds. In addition, it has also established itself as a specialist exchange in truly alternative funds that invest in a broad range of assets; the CISX already lists the first wine fund, two art funds and forestry and tree funds.

The CISX itself is innovative in its approach to delivering an unrivalled service, combining flexibility with responsibility, and accepts a wide range of innovative products. One recent highlight has been the listing of nine innovative new funds by Arab Bank, which has the biggest branch network of any Middle East bank. The new funds are a mixture of traditional and Sharia’a compliant vehicles. The Exchange has also listed a fund which has been domiciled and administered in Guernsey in order to fund the building of the UK’s largest data centre. The PFB Data Centre Fund has been set up to focus on the specialist property sector and has entered into a joint venture with a German-based developer.

**Advantages of a CISX Listing**

The structure of the CISX has been specifically designed to differentiate it from other exchanges. The Exchange’s membership structure allows Channel Islands fund management groups as well as law and accountancy firms to become Listing Members. An issuer wishing to have its securities listed on the CISX is required to engage the services of a Listing Member to act as sponsor. One advantage of the membership structure is that many international issuers may utilise an existing professional service provider or fund manager that is a member of the CISX, thus facilitating a one-stop-shop and potentially saving on costs.

The Market Authority accepts a wide range of legal structures for admission to the Official List, including protected cell companies and limited partnerships. With regard to the specialist debt sector, the Market Authority recognises that such securities are typically targeted at institutional investors, thus it approaches the listing of specialist debt securities in a very pragmatic way. Disclosure of information is kept to a minimum, focusing on the key features of the debt issuance programme or debenture, the terms and conditions of the issue and, in the case of asset-backed securities, the underlying assets.

The listing of debt on a recognised stock exchange – as the CISX is by the UK tax authorities – exempts UK issuers from withholding tax on interest payments to investors outside the UK, a provision known as the quoted Eurobond exemption. This is important given the role of debt in private equity acquisition structures and the use of so-called payment in kind notes to pay interest in order to minimise cash payments during the life of the loan. While these payments in kind trigger tax deductions for the issuer, withholding tax becomes payable, hence the importance of the quoted Eurobond exemption to mitigate this tax liability. Since the exemption applies to interest paid as opposed to accrued, it means unpaid interest that accrued before the listing of the debt can escape the tax if it is paid subsequently.

As well as the CISX, various other stock exchanges within the EU are recognised for the purposes of the exemption. However, because the Channel Islands are not members of the EU, issuers are not subject to a wide range of European legislation including the Prospectus Directive and the Transparency Directive. This means, for example, that there is no requirement to prepare accounts according to International Financial Reporting Standards, with all the additional costs and complexity that entails; the Exchange offers issuers the flexibility...
to use US or UK GAAP instead. This is on top of flexibility in other areas, such as continuing obligations, and the speed and efficiency that gives the Exchange an advantage in terms of listing turnaround time.

Trading Facility
The CISX’s market continues to develop, with trading volumes and turnover steadily increasing. The Exchange offers a full listing and trading facility for commercial trading companies and closed-ended investment companies. Shares that are partly-paid may also be traded. There are market makers and an order book facility, with transactions having the advantage of full CREST settlement. In March 2005, the Exchange extended the trading facilities to open-ended investment companies.

Trading is conducted every weekday excluding public holidays and takes place on a continuous basis during normal trading hours of 9.00am to 4.30pm. Orders and quotations may be added, deleted, or amended on the trading system by Trading Members prior to normal trading hours between 8.00am and 9.00am.

Visibility
Market data is distributed worldwide through Reuters and via the CISX website.

Recently introduced features on the CISX website include the publication of news on CISX-listed securities and the ability to search for market data including corporate actions, closing prices, net asset values and other information on listed companies by a variety of search facilities such as security type, date of listing, domicile, etc.

The enhanced services of the CISX website will ensure that the Exchange delivers timely market news to a wider audience. Its technical design has created a dynamic site and offers greater flexibility to the Exchange to respond to future developments. The CISX website is under continuous development to provide enhanced services to investors and issuers alike.

The CISX offers an opportunity for those international businesses already attracted to the Channel Islands to take advantage of a personalised approach and fast track processing of applications within a highly regulated and innovative marketplace. As the 10th anniversary celebrations for the Exchange reach a conclusion, it is looking forward to the future with confidence, knowing that with the support of its Members, the CISX is in a good position to carve for itself a strong and secure presence in the global marketplace.