Forum for U.S. Securities Lawyers in London

Investment Company Act Section 3(c)(7) Model Procedures for Equity Issuances in the London Capital Markets

Disclaimer

These model procedures have been developed through consultation with a working group comprised of various members of the Forum for U.S. Securities Lawyers in London (the "Forum"). These model procedures are for discussion purposes only, do not constitute legal advice, do not necessarily reflect the opinion of any individual, law firm, financial institution or other organization that has participated in meetings of the Forum and do not reflect the opinions of the London Stock Exchange (the "Exchange"), Euroclear U.K. & Ireland Limited ("EUI") or any other market participant who has participated in any Forum activities relating to the London Equity Procedures 2012. These model procedures are intended to be a set of parameters that legal advisors can use to construct a framework for an issuer to comply with Section 3(c)(7) of the Investment Company Act of 1940, as amended. The construction and use of this framework should be applied on a case-by-case basis.

These guidelines have been prepared independently of regulations, the Exchange and electronic settlement systems, including EUI, and do not form part of the CREST electronic settlement system operated by EUI ("CREST") admission procedures. The possible admission of securities to an electronic settlement system, including the CREST system, remains at the discretion of the applicable electronic settlement system, which will review their eligibility for settlement in accordance with its own rules and requirements.

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Introduction

These model procedures (the "London Equity Procedures 2012") for equity issuances in the London capital markets under Section 3(c)(7) ("Section 3(c)7)") of the Investment Company Act of 1940, as amended (the "Investment Company Act") contain procedures designed specifically for the London capital markets that may be used by non-U.S. investment companies seeking exemption from registration under Section 3(c)(7) of the Investment Company Act. The London Equity Procedures 2012 are only appropriate for non-U.S. issuers.

These model procedures are intended to be a set of parameters that can be applied so that issuers may sell securities to U.S. investors while utilizing the Depository Trust & Clearing Corporation ("DTC") and/or the CREST electronic settlement system ("CREST") operated by Euroclear U.K. & Ireland Limited ("EUI") in compliance with Section 3(c)(7). They should be applied on a case-by-case basis, taking into account, among other factors, the specific characteristics of the issuer and the offering, including its management, tax structure, the location and type of investors expected to participate in the transaction and expected U.S. investor interest in the offering, as well as the relevant rules and requirements for admission of the securities to the London Stock Exchange (the "Exchange") and the CREST system. See "Issuer Considerations When Developing Procedures" below.

In addition, while we recognize that in rare instances it may be difficult to determine if an issuer is potentially covered by the Investment Company Act, we do not, however, advocate the "prudential" application of Section 3(c)(7) procedures outside of those rare instances given the unnecessary costs and burdens they impose on issuers, underwriters and investors.

Legal Background

The Investment Company Act prohibits an "investment company" from publicly offering securities in the United States unless it is registered under the Investment Company Act or an exemption from registration applies.[1] Registration subjects the company to far-reaching public disclosure requirements, including the company's investment objectives, types of investments, recordkeeping and its overall structure and operation.[2] Under the Investment Company Act, the definition of an "investment company" is broad and, in addition to covering traditional mutual fund-type investment companies, can include entities with investment securities comprising more than 40% of their total assets, including operating companies that have substantial minority interests in other companies.[3]

Section 3(c)(7) was introduced to the Investment Company Act in 1996 through the National Securities Markets Improvement Act ("NSMIA").[4] The provision was intended to facilitate private placements into the United States by U.S. and non-U.S. investment companies. Section 3(c)(7) provides an exemption from registration under the Investment Company Act for issuers placing securities to highly sophisticated investors who meet the definition of "qualified purchasers" ("QPs") under the Investment Company Act, who are capable of evaluating such investments and the related financial risk and do not require the same level of protection as retail investors.[5] Section 3(c)(7) does not limit the number of investors to which an issuer may sell its securities so long as such investors are

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[1] *See* Sections 6 and 7(a) of the Investment Company Act.
[2] *See* Section 8(b) of the Investment Company Act.
[3] *See* Section 3(a) of the Investment Company Act.
[4] 62 FR 28112 (May 22, 1997).
[5] *See* Section 2(a)(51) of the Investment Company Act. The holders must be deemed to be "qualified purchasers" at the time of their acquisition of securities. Under Section 3c-5, "knowledgeable employees" may also acquire securities in addition to qualified purchasers. In addition, a foreign investor temporarily present but not resident in the United States may purchase an interest in a foreign issuer without having to be a QP under Section 3(c)(7). Wilmer, Cutler & Pickering, Davis, Polk & Wardwell (avail. Oct. 5, 1998).

all QPs.[6] Because of this, many issuers prefer the Section 3(c)(7) exemption over the other major Investment Company Act exemption, Section 3(c)(1), which imposes a 100-investor limit.

Issuers may make limited private placements of securities into the U.S. capital markets based on certain exemptions under the Investment Company Act and U.S. Securities and Exchange Commission ("SEC") staff interpretations thereof. In particular, under Section 3(c)(7), an issuer whose securities are acquired by U.S. persons who are QPs and in a private placement using an available exemption from registration under the U.S. Securities Act of 1933, as amended (the "Securities Act"), will not be required to register as an "investment company."[7]

Section 2(a)(51) of the Investment Company Act defines the term "qualified purchaser" to include (i) any natural person who owns not less than $5 million in qualifying investments (including investments held jointly with such person's spouse), (ii) certain family-owned companies, including trusts, owning not less than $5 million in investments that are "owned directly or indirectly by . . . direct lineal descendents," (iii) certain other trusts or (iv) any person, acting for its own account or the accounts of other qualified purchasers (i.e., institutional investors) who in the aggregate owns and invests on a discretionary basis not less than $25 million in investments. Rule 2a51-1(g) under the Investment Company Act also provides that, with certain very limited exceptions, "qualified institutional buyers" ("QIBs") as defined in Rule 144A under the Securities Act shall be deemed to be QPs so long as the investor meets certain minimum investment holdings requirements and, in the case of certain benefits plans or trust funds, meets certain investment control requirements.[8]

In order to comply with Section 3(c)(7), an issuer must establish a "reasonable belief" that the U.S. holders of its securities are QPs at the time such securities are acquired.[9] Issuers must also establish procedures to support a reasonable belief that U.S. persons who subsequently purchase the securities in the United States (i.e., not a foreign market) will be QPs at the time of purchase of such securities.[10]

The monitoring of subsequent transfers is particularly problematic in the London capital markets due to limitations in the relevant trading and settlement systems, which are not equipped to easily identify the beneficial owners of securities or to require certifications from them. Issuers must therefore rely on other methods to establish a reasonable belief that U.S. investors are QPs in order to maintain the Section 3(c)(7) exemption. Under the Investment Company Act, a non-U.S. issuer may take advantage of the Section 3(c)(7) exemption if at the time of the offering (i) it did not engage in a public offering in the United States and (ii) all U.S. investors are QPs. The SEC has provided additional guidance on the use of this exemption in the Goodwin Proctor No-Action Letter, which

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[6] Greene, Beller, Rosen, Silverman, Braverman and Sperber, *U.S. Regulation of the International Securities and Derivatives Markets, Eight Edition* ("Greene"), *§ 12.06[1] Private Offerings by Foreign Funds* (2008).

[7] Goodwin, Procter and Hoar, SEC Staff No-Action Letter (avail. Feb. 28, 1997) ("Goodwin Procter No-Action Letter").

[8] Rule 2a-51(g)(1) states that:

> [a]ny Prospective Qualified Purchaser who is, or who a Relying Person reasonably believes is, a qualified institutional buyer as defined in paragraph (a) of Rule 144A under the Securities Act of 1933, acting for its own account, the account of another qualified institutional buyer, or the account of a qualified purchaser, shall be deemed to be a qualified purchaser provided:
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> (i) That a dealer described in paragraph (a)(1)(ii) of Rule 144A shall own and invest on a discretionary basis at least $25 million in securities of issuers that are not affiliated persons of the dealer; and
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> (ii) That a plan referred to in paragraph (a)(1)(i)(D) or (a)(1)(i)(E) of Rule 144A, or a trust fund referred to in paragraph (a)(1)(i)(F) of Rule 144A of this chapter that holds the assets of such a plan, will not be deemed to be acting for its own account if investment decisions with respect to the plan are made by the beneficiaries of the plan, except with respect to investment decisions made solely by the fiduciary, trustee or sponsor of such plan.

[9] *Ibid.*

[10] Greene, § 12.06[1]. The "reasonable belief" may not be formed exclusively on the basis of "deemed" representations included in the prospectus. The formation of a reasonable belief must be made in good faith and the SEC left open the possibility that an issuer could develop procedures in the Rule 144A market to support the requisite reasonable belief. *See* American Bar Association Section of Business Law (avail. Apr. 22, 1999).

provides that a non-U.S. issuer who has otherwise followed all of the requirements of Section 3(c)(7) may use the exemption even when U.S. persons who are not QPs have purchased its securities in the secondary market.[11] However, in these circumstances, a non-U.S. issuer must then set in place procedures designed to ensure that securities subsequently transferred by U.S. persons are only transferred to other U.S. persons who are also QPs, unless such transfer is made on the Exchange and certain other conditions are met. In order to take advantage of the Goodwin Proctor No-Action Letter, some issuers require all resales of their securities, including those made by U.S. persons, to be made on the Exchange (i.e., on the secondary market). When establishing such procedures, the SEC has specifically stated that (i) mere belief by the seller of the securities that the purchaser is a qualified purchaser is insufficient for the issuer to rely on the Section 3(c)(7) exemption (i.e., the issuer itself must also hold such reasonable belief[12] (for example, it may require a certification from the purchaser to this effect)); and (ii) such "reasonable belief" by the issuer may not exclusively be formed on the basis of "deemed representations."[13] What procedures would support a reasonable belief has been the subject of debate in the legal community for many years.

The London Equity Procedures 2012

There are procedures of general application for equity offerings by issuers taking advantage of the Section 3(c)(7) exemption (the "2008 Procedures").[14] Although certain features of the 2008 Procedures have been used in some transactions in Europe since their publication, the 2008 Procedures include some procedures that are specific to U.S. capital markets transactions and, therefore, raise some practical difficulties when applied to London-listed transactions. Recognizing that the London equity capital markets have unique characteristics, including the rules and regulations of the Exchange and the CREST settlement system, the Securities Industries and Financial Markets Association ("SIFMA") European Primary Markets Division, now known as the AFME ("AFME"),[15] addressed some of these practical difficulties from an underwriter's perspective in their 2009 draft "London equity variations to the 2008 3(c)(7) Procedures" (the "2009 Procedures"). In addition, in March 2012 additional commentary to the 2008 Procedures was circulated (the "2012 Commentary").[16] The 2012 Commentary did not substantively alter the 2008 Procedures, but noted some of the difficulties in strictly applying the 2008 Procedures outside the United States and conceded it would be appropriate "to identify offerings with respect to which greater flexibility appears to be appropriate . . . ."[17] The London Equity Procedures 2012 are intended to provide additional guidance as to tailoring transactions to the unique features of the London equity capital markets, and also embrace most of the features of the 2009 Procedures and the 2012 Commentary, in addition to capturing the range of market practice that has developed around the wide range of issuers in London.

Please note that implementing the London Equity Procedures 2012 is not the equivalent of automatic compliance with all applicable U.S. securities laws and that it is the responsibility of the issuer and its advisors to satisfy their obligations under all applicable U.S. securities laws in any relevant transaction. The London Equity Procedures 2012 have been developed by a consortium of U.S.-qualified lawyers in London, and have been informed by market practice, analogy to treatment of other "restricted securities," review of SEC no-action letters, and applicable law and regulations.

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[11] The Goodwin Procter No Action Letter.

[12] *See* American Bar Association Section of Business Law (avail. Apr. 22, 1999).

[13] Greene, § 12.06[1].

[14] *See* "Book Entry Deposit Procedures for Certain Offerings by Non-U.S. Issuers Under Section 3(c)(7) of the Investment Company Act," which appeared in *The Investment Lawyer*, Vol. 10, No. 3, March 2003.

[15] AFME was formed in November 2009 through the merger of the London Investment Banking Association and the European arm of SIFMA.

[16] See "Investment Company Act Status of Non-U.S. Issuers, Updated Commentary on Book-Entry Deposit Procedures Under Section 3(c)(7) of the Investment Company Act", which appeared in The Investment Lawyer, Vol. 19, No. 3, March 2012.

[17] Ibid, page 21. For example, to address the risk of flow-back of securities into the United States in offshore secondary trading, the 2008 Procedures contemplated that the underwriters would follow additional procedures during a 40-day period following completion of the transaction. However, the 2012 Commentary noted alternative transfer restrictions or procedures may be more appropriate in lieu of such a 40-day restricted period. We also note there is no requirement to impose such a 40-day restricted period under Rule 3(c)(7) or the relevant no-action letters.

Issuer Considerations When Designing Procedures

When an issuer and its advisors are designing procedures for compliance with Section 3(c)(7), various factors should be considered in the analysis, including: (i) potential U.S. market interest in the transaction; (ii) potential retail market interest in the transaction; and (iii) any connection between the issuer and the U.S. capital markets.

If an issuer is a fund or another type of investment company, and is marketing to potential U.S. investors or anticipates that there will be a significant U.S. interest in its securities, it will need to evaluate its connection to the U.S. capital markets in order to design appropriate procedures and should consider the following factors, among others:

a. whether its fund managers or principal operations are based within the United States;

b. whether it has adopted special voting and management mechanisms or structures to ensure that it remains a "foreign private issuer" for purposes of the Securities Act and the U.S. Exchange Act of 1934, as amended;

c. whether there is an existing U.S. shareholder investor base, either from pre-IPO offerings or a significant U.S. offering is anticipated in the IPO;

d. whether it (i) is structured so as not to be a Passive Foreign Investment Company (PFIC) (as defined under Section 1297 of the Internal Revenue Code of 1986, as amended), (ii) provides information to allow a Qualified Election Fund (QEF) and/or (iii) allows “benefit plan investors” (as defined under the Employee Retirement Income Security Act of 1974, as amended (ERISA)) and thus is likely to lead to heightened U.S. investor/analyst interest or make the securities more attractive to U.S. investors;

e. whether the securities will be cleared through the DTC and become PORTAL enabled;[18]

f. the depth of the expected trading market outside the United States; and

g. whether some feature of the securities will attract significant U.S. investor interest (for example, the issuer’s industry or sector, the jurisdiction of the issuer, legal and tax features of the issuer’s jurisdiction, the structure of the issuer or the public profile of the issuer).

This is not an exhaustive list and an issuer may take other factors into consideration when determining whether the London Equity Procedures 2012 are appropriate for use or when designing procedures for a transaction using the London Equity Procedures 2012.

For the purposes of rendering an opinion, it would be prudent to have consensus from all relevant members of the working group, including on the nature and extent of procedures that are utilized to establish a basis that “reasonable procedures” have been implemented for the transaction in question as required by Section 3(c)(7). As stated above, “reasonable procedures” is a judgment call to be made by the working group on a transaction by transaction basis taking into account the characteristics of each transaction, including the factors listed above.

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[18] That is, being capable of being traded on the NASDAQ PORTAL Market Trading System, which is a centralized trading and negotiation system for trading between QIBs of Rule 144A securities

LONDON EQUITY PROCEDURES 2012

	Model Procedures	*Considerations*
Issuer-Related Issues	**Foreign Private Issuer** The issuer must be a foreign private issuer and must represent and warrant in the purchase agreement or underwriting agreement that it is a "foreign private issuer" as defined in Rule 405 under the Securities Act. A "foreign private issuer" is an entity incorporated or organized outside of the United States, other than a foreign government, unless (i) over 50% of its voting securities held of record are either directly or indirectly owned by U.S. residents; and (ii)(a) the majority of its executive officers or directors are U.S. citizens or residents, (b) more than 50% of its assets are located in the United States or (c) its business is administered principally in the United States.	**Foreign Private Issuer** The increasingly cross-border nature of capital markets poses additional regulatory challenges. While the Section 3(c)(7) exemption is available to domestic U.S. issuers, the London Equity Procedures 2012 are designed to assist foreign private issuers with the unique challenges of complying with Section 3(c)(7) in London transactions. U.S. domestic issuers are treated differently under the Investment Company Act and the Securities Act, and therefore fall outside the scope of these procedures. The "foreign private issuer" definition contains certain objective thresholds concerning the issuer. As a corporate entity, some of these characteristics may change over time. Should the issuer be close to the threshold for maintaining foreign private issuer status, then it may want to consider setting in place mechanics to ensure such issuer retains its status as a foreign private issuer (e.g., instructing the registrar to monitor register, monitoring the location of the board meetings and the composition of the board (i.e., the residence of board members, senior officers and directors)).
	Constitutive Documents The issuer incorporates into its constitutive documents the right to force the resale or redemption of the securities if a purchaser or transferee violates the applicable purchase or transfer restrictions or for other legal or compliance issues, and the right to refuse to honor any non-compliant transfers (subject to applicable listing and settlement rules and	**Constitutive Documents** These provisions are a failsafe mechanism allowing issuers to correct any potential noncompliance with the other measures set in place to establish reasonable procedures, by allowing the issuer to force the redemption or resale by any shareholder

	Model Procedures	***Considerations***
	requirements).	who may be holding securities and who may have acquired the securities in a manner that would jeopardize the issuer's Section 3(c)(7) exemption. These are important protections, particularly as the issuer cannot directly prevent non-compliant transfers of securities. The issuer and the registrar may not refuse to recognize any sale of securities settled in the CREST system. The forced resale or redemption provisions are, on the other hand, acceptable to the UK Listing Authority ("UKLA") and the Exchange and, if properly structured, to the CREST system as well.
	Representations and Covenants of the Issuer The issuer should be prepared to make the following types of representations and covenants: The issuer covenants that it will not, and will not permit its agents, intermediaries or affiliates to, resell any of its securities to U.S. persons (unless it reasonably believes that such U.S. purchasers are QIB/QPs**,** and each such U.S. purchaser signs a representation letter for the file). Such a restriction is often included in underwriting or purchasing agreements in order to prevent the issuer from inadvertently violating the requirements of securities laws, including the Section 3(c)(7) exemption and the registration requirements of the Securities Act. Additionally, the issuer should represent that it reasonably believes that the procedures put in place will limit sales to QIBs/QPs. Additional representations may be included depending upon the agreed procedures for a particular transaction.	**Representations and Covenants of the Issuer** These representations and covenants form part of the reasonable procedures put in place for compliance with Section 3(c)(7) and other U.S. securities laws and provide comfort to the underwriters that the issuer will ensure compliance on an ongoing basis. Additional representations may be required by underwriters from investors and issuers in transactions, depending upon the agreed procedures. From the perspective of U.S. counsel, the issuer's representations and covenants will also form a basis for counsel's Investment Company Act opinion to be delivered in connection with an offering, particularly as the analysis requires the issuer's "reasonable belief" that purchasers are QPs.

	Model Procedures	***Considerations***
London Stock Exchange Measures ***NB: We are currently in the process of finalizing these measures with the London Stock Exchange***	**"Section 3(c)(7)" Naming Convention** At its option, the issuer (and in the case of an issuer on the AIM market of the Exchange, its Nominated Advisor ("NOMAD")) will be able to elect to use the Section 3(c)(7) marker which the Exchange includes in the "short name" of an issuer, "(INVC)."[19] This marker will remain in place until the issuer (and in the case of an issuer on the AIM market of the Exchange, its NOMAD) elects to remove it. **The Exchange's Trading System and Internal Sectors** The Exchange's trading system will separate the securities of Section 3(c)(7) issuers into their own internal sector so that they are processed and maintained separately from other listed issuers. **The Exchange's Rules and Guidance Notes on Section 3(c)(7) and Compliance with U.S. Securities Laws** To maintain the Exchange's regulatory standards and ensure respect for international securities laws that may affect the market, the Exchange continues to update and modify its rules and guidance for members on international securities laws, including U.S. federal securities laws. This includes the Exchange's Rule and accompanying "Guidance Note on Section 3(c)(7) securities ***[Exchange citation to be inserted]***, which requires all members of the Exchange to trade Section 3(c)(7) securities in compliance with U.S. federal securities laws. **List of Section 3(c)(7) Issuers on the Exchange's Website** The Exchange maintains a list on its website of Section 3(c)(7) issuers on both AIM and the Main Market which it updates on a regular basis. ***[INSERT URL]***	**"Section 3(c)(7)" Naming Convention** This measure will provide a "marker" as part of the Exchange's naming convention that will be present at the trading level and at the settlement level in the CREST system. This marker is intended to put members of the Exchange and potential investors on notice that the issuer is relying on Section 3(c)(7) and has procedures in place to ensure compliance with Section 3(c)(7). Use of the Exchange marker would always be at the option of the Issuer and would not be mandated by the Exchange, nor is it a specific requirement of Section 3(c)(7), the Goodwin Proctor No Action Letter, any other relevant No Action Letter or any SEC guidance. If the marker is used in a transaction, investment banks may require issuers to covenant in the underwriting agreement that they will maintain the marker for an agreed period of time. Using such a marker would always be at the option of the issuer and would not be mandated by the Exchange.

[19] For example, if a company's "short name'" is ABC, then the marker would read "ABC (INVC)."

	Model Procedures	***Considerations***
Minimum Initial Placing to U.S. Institutional Investors	While having minimum denominations is a feature of the Section 3(c)(7) debt procedures, this is not practicable in the London equity markets, and is generally difficult to achieve in any international equity market. In the event there is concern over U.S. retail investor interest, an issuer may consider putting in place minimum initial purchase requirements for each U.S. investor to deter retail investors from purchasing the securities.	While not a typical feature within the London market, in the rare case in which there may be unusually high U.S. investor interest in the securities, an issuer may consider including minimum initial holding requirements for U.S. investors in their procedures because this would mimic procedures for minimum denominations used in debt transactions with a Section 3(c)(7) exemption. If these requirements are also applied to resales, the issuer should provide notice of the minimum holding provisions and require certification of compliance with such requirements upon each resale by each subsequent purchaser. This would most likely be achieved through a certification letter in which such subsequent purchaser certifies its compliance with the minimum holding requirement, along with its QP status and other relevant representations and warranties. We are not aware of restrictions on amounts in the London market for resales and such restrictions may present technical and regulatory issues, which will need to be addressed by the working group for a particular transaction. In the case of preemptive rights, which apply to some secondary offerings in the London market (e.g., rights issues and placings and open offers), the use of minimum holdings may be technically difficult to implement because U.K. law provides U.S. shareholders the right to purchase additional securities in proportion to their existing holdings in order to prevent dilution. Ultimately this procedure may create issues that would need to be addressed by the transaction's working group. The 2008 Procedures prescribed a minimum initial

	Model Procedures	***Considerations***
		placing of $250,000 to U.S. persons, which was carried over into the 2009 Procedures.[20] We believe that for the London equity market a minimum initial purchase requirement should be set on a deal-by-deal basis, depending on the size of the transaction. In setting a minimum, a useful reference is €100,000, which is the minimum for the private placement exemption under the Prospectus Directive.[21] However, the determination of this amount should be conducted on a case-by-case basis depending on specific factors in each transaction, including the size of the offering and other relevant characteristics as discussed herein. (*See Issuer Considerations When Designing Procedures,* above.)
Section 3(c)(7) Public Notification, Annual Reminder Notice and Annual Registrar Audit	**Public Notification** The issuer should provide details of its reliance on Section 3(c)(7) and details of the related restrictions and procedures on the investor relations page of its website. **Annual Reminder Notice** The issuer should issue an annual reminder to shareholders and the market via its annual report stating that each U.S. holder must be a QIB/QP or have validly purchased the shares on the Exchange in a non-pre-arranged trade. This notice serves as a continuing reminder that should the issuer become aware the securities are not validly held under Section 3(c)(7), the issuer will either (i) force the resale of the securities in	**Public Notification and Annual Reminder Notice** The first two procedures are notification methods that are well established in Section 3(c)(7) debt practice and the Forum considers them to be best practice for equity transactions. Supplementing the issuer's efforts to provide notice to the market of its reliance on Section 3(c)(7) is the Exchange notice convention and its accompanying guidance, which put Exchange members, including brokers and other market participants, on notice as to restrictions.

[20] The 2008 Procedures also required minimum denominations of $250,000. However, as also noted in the 2009 Procedures, minimum denominations cannot be accommodated for London equity listings.

[21] Currently, the minimum denomination exemption under Article 3 of the Prospectus Directive (Directive 2003/71/EC) is €50,000. However, EU Directive (2010/73/EU) (the "Amendment Directive"), published on 11 December 2010, amends the Prospectus Directive to increase the minimum denomination to €100,000; the provisions of the Amendment Directive must be implemented by Member States by July 1, 2012. For the Prospectus Directive and supporting materials, *see* http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm. The $250,000 figure forms part of the blue sky laws of certain U.S. states and has a history of application in the debt context. *See* Corporate Finance and the Securities Laws — McLaughlin and Johnson,§ 7.09, Private Placement Procedures.

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	order to restore compliance with the selling restrictions or (ii) redeem the securities. **Annual Registrar Audit** An additional procedure that issuers may consider would be to have their registrar audit on an annual or semiannual basis the issuer's shareholder register to determine the number and type of U.S. holders and the amount of securities held by them.	**Annual Registrar Audit** While rarely used, the third procedure may be useful to issuers who are particularly concerned that they have high U.S. investor interest or are frequent issuers and want to ensure that Section 3(c)(7) will be available to them for follow-on offerings. We note that the analysis of beneficial holders of securities is difficult, costly and can have a limited degree of accuracy.
Mechanics of Issuance	**Options for Issuance** **Settlement in Uncertificated, Registered Form (for use with appropriate procedures)** All shares are dematerialized into the CREST system with reasonable procedures in place for compliance with the Section 3(c)(7) exemption. Securities are issued in uncertificated, registered form and settled directly through the CREST system. **Custodian for U.S. Holders** Implementation of this procedure would require establishment of a separate line of securities monitored by a custodian for U.S. investors. **Legending of Global Share Certificate** When a custodian holds a global share certificate, it must contain a legend detailing the transfer restrictions applicable to the securities,	**Options for Issuance** There are a range of options for issuance when relying on Section 3(c)(7). While the first option is the most commonly used in the London market, in exceptional circumstances practitioners may consider the second and third options depending upon the criteria of the issuer (see above) and the transaction itself. In particular, where there is greater potential U.S. investor interest or large numbers of U.S. shareholders, the second and third options may be considered. The standard method is generally available when there is a reasonable belief that the procedures designed for a transaction are sufficient. We note that the alternative option of using a custodian is very rare and while it has not been

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	the Section 3(c)(7) portion of which may not be removed for the life of the issuer. **Euroclear/Clearstream** London-listed securities may also be traded through Euroclear and Clearstream accounts. Hence, a custodian can be established through Euroclear and Clearstream. **DTC** DTC is generally not used for settlement of London listings and such non-use would be consistent with limiting numbers and excluding non-institutional U.S. investors. **Exit Letter** Agreement by U.S. purchasers in an offering to deliver to the issuer or its registrar, prior to the settlement of any transfer of securities, an exit letter signed by the transferor stating that the security was sold in an offshore transaction in accordance with Regulation S under the Securities Act	used in the London market to date, it has been used in European market offerings in which there was a retail offer in conjunction with a high-profile U.S. issuer with extensive connections to the United States and an expectation of U.S. secondary trading permitting resales to QIBs/QPs. The 2012 Commentary recognizes that there are circumstances in which a gatekeeper custodian would not be used. An explanation as to why the alternative option has not been seen in the London market is that it is both burdensome and problematic from a commercial and, more importantly, a regulatory perspective. Some of the issues it presents include the creation of two lines of securities, lowering liquidity for the shares and reduced transparency in pricing. For these reasons, among others, the Exchange discourages this when other alternative reasonable procedures are available to an issuer. This option also presents a variety of U.K. regulatory and technical concerns regarding trading and settlement mechanics (e.g., requirements of free transferability and disclosure issues). The 2009 Procedures included additional concerns regarding the use of the alternative option in the London market.[22] **Exit Letter** We note that exit letters are sometimes delivered by initial U.S. investors upon resale, to certify that the sale is being conducted offshore (and generally also that the securities are being sold to persons not known by the seller to be U.S. persons); however,

[22] The 2009 Procedures noted : (i) the reaction of UKLA regarding fee transferability/market distortion concerns; (ii) how will the market understand that a beneficial interest, rather than the underlying security, is being transferred? How will the trade be reported?; (iii) treatment of custodian for disclosure/Takeover Code purposes?; and (iv) SD/SDRT concerns depending on location of custodian and register of beneficial interests — would need to be offshore for U.K. purposes?

	Model Procedures	***Considerations***
	("Regulation S").	this requirement is not standard and is a feature of transactions in which there is heightened concern about the level of U.S. interest in the securities. If no U.S. resales are permitted then the point is typically dealt with by the deemed representation made by the initial U.S. placees that the offshore resale cannot be made to someone known to be a U.S. person and in accordance with Regulation S.
Limitation on Number of Potential U.S. Investors to Be Approached	In some transactions a limit has been placed on the number of potential U.S. investors approached in connection with marketing exercises, including existing U.S. security holders of the issuer, if any.	Applying by analogy to SEC guidance with respect to private placements under the Securities Act, some believe that limiting the overall position of U.S. investors in the issuer's securities will support the issuer's position with respect to reasonable procedures to ensure compliance with Section 3(c)(7). Whether to impose such a limit and, if imposed, the exact number of investors to be approached, is a matter for agreement within the working group on any particular transaction and will depend upon the characteristics of such transaction and the underwriters' internal policies. Generally, the market has seen U.S. investor limits of 250 or more in certain cases.[23] A limit, if any, should be determined on a case-by-case basis by the working group, taking into account the specifics of the transaction and other considerations. Although in certain transactions limits have been placed on both the number of U.S. investors approached as well as the number of U.S. investors permitted to purchase in the offering, the better approach seems to be to only limit the number of

[23] However, there is no guidance on this point in Section 3(c)(7) or in the relevant no-action letters.

	Model Procedures	***Considerations***
		U.S. investors to be approached to a number appropriate for the transaction.[24] See "Percentage of Offering in the United States" below.
U.S. Investor Letter	Each initial U.S. purchaser of the securities shall execute a purchaser representation letter containing, inter alia, the following statements: **QIB/QP Status** Representation that it is a QIB/QP, purchasing for its own account, or for the account of one or more QIB/QPs, each of which is acquiring the beneficial interests in the securities for its own account. If the offering is to include U.S. purchasers who are not QIB/QPs (i.e., sophisticated individuals who meet the definition of a QP), the 2008 Procedures may be more appropriate; this issue should be dealt with on a case-by-case basis.	Receipt of the U.S. investor letter would be at the time the order is placed for the relevant security or, more commonly, before closing; however, in practice, this sometimes proves difficult and these letters are received at a later time. Therefore, there have been circumstances where market participants have accepted relying on investors as having given deemed representations in the prospectus and letter even if they have not received the signed representations prior to closing. To this effect, the prospectus and letter should tell the investors that by purchasing the securities they are deemed to make such representations regardless of whether they return the letter. Additionally, underwriters in such circumstances may accept counsel's opinion to assume the investors will comply with the representations and undertakings in the investor letters. **QIB/QP Status** This representation forms part of an issuer's reasonable procedures as it provides a foundation for the issuer's reasonable belief that U.S. investors are QIBs and QPs. This also provides back-up for the related representations in the underwriting agreement, as well as providing assurances for

[24] The applicable rules and no-action letters do not require a limitation on the number of investors approached. Commercial considerations may also factor into any limits on the number of investors approached based on the level of interest among prospective investors.

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		future compliance in the secondary market.
	Resale Restrictions Purchaser makes agreement to resell only either to known U.S. persons that are QIB/QPs with daily chain of representation letters or only through a designated offshore securities market (as defined in Regulation S), or offshore outside the United States to known non-U.S. persons, or with no prearrangements to sell to U.S. persons. Additionally, in certain transactions in which resales are not limited to being made in the London market, there may be an additional representation required to the effect that resales may only be made to a U.S. person who is a QIB/QP and executes a representation letter agreeing to these restrictions, which is delivered to the issuer or its registrar prior to the settlement of the transfer.	**Resale Restrictions** If the issuer is relying on the Goodwin Procter No-Action Letter, it may choose to only allow resales on the Exchange in order to avoid additional procedures related to monitoring off-market trades to U.S. persons. Should an issuer feel obligated to make off-market trades available to its shareholders (by not prohibiting them) or should it have concerns about its ability to rely on the Goodwin Procter No-Action Letter (i.e., due to a close connection to the United States, including a large percentage of U.S. investors or a high level of U.S. investor interest), it will request an additional representation regarding resales to U.S. persons.
	Acknowledge Issuer's Right to Force Resales The purchaser makes an acknowledgement of the issuer's right to force the resale or redemption of the securities, and to force resales of any non-complying purchases or transfers, if a purchaser or transferee violates these representations (insofar as lawful and acceptable to the UKLA). Investors should be made aware that forced resales may occur in situations in which no violation of the transfer restrictions exists, but the resale is being forced in order to reduce the overall number of U.S. holders.	**Acknowledge Issuer's Right to Force Resales** This measure ensures that investors are on notice of the provisions of the issuer’s right to force resales contained in the constitutive documents.

	Model Procedures	***Considerations***
	Notification of Restrictions on Resales Agreement by investor to notify executing broker (and any other agent of the transferor involved in selling the securities) in any resale by it in the future of the restrictions that are applicable to the securities being sold, with an instruction to the broker (and such other agent) to abide by such restrictions.	**Notification of Restrictions on Resales** This is an available option to ensure that future purchasers of the securities are put on notice by their respective broker-dealers of the relevant transfer restrictions on the securities.
Percentage of Offering in the United States	Generally, following the completion of an offering, no more than 45% of the issuer's share capital should be held by U.S. persons in the initial offering. The issuer, the underwriters and respective U.S. counsel will agree on the limited number of U.S. investors to be approached in marketing the offering. (See also *Limitation on Number of Potential U.S. Investors to Be Approached* above.)	This provides a foundation for the issuer to establish the reasonable belief that the transaction is not primarily targeting U.S. investors. The 45% threshold was established in the 2008 Procedures for this purpose. The 2008 Procedures did note, however, that a higher percentage threshold may be appropriate in certain circumstances. For instance, where the primary trading market is offshore, a significant amount of the secondary trading is expected to involve non-U.S. persons and, due to prior offerings, upon completion of an offering, the amount of the issuer's securities held by U.S. persons will be significantly lower than 45% of the aggregate number of outstanding securities of the issuer.[25]
Underwriter's Representations and Warranties in the Underwriting Agreement	The underwriting agreement shall contain, inter alia, the following statements: QIB/QP Certification	These (i) form part of the basis for counsel to issue an Investment Company Act opinion because they include matters of fact and opinion on which the legal analysis relies; and (ii) provide assurances to the issuer that the underwriters will comply with the reasonable procedures designed for the transaction

[25] While the 45% U.S. holding limitation proposed may be sensible from a foreign private issuer perspective (assuming one of the other three legs of the FPI definition has been met), for a Section 3(c)(7) offering there seems to be little basis for limiting the total number of U.S. investors to fewer than 100, as would be the case in a Section 3(c)(1) offering. The analogy in Goodwin Proctor to Section 3(c)(1) related to how resales in offshore markets could be structured in the Section 3(c)(7) context (e.g. how in certain cases purchases by U.S. persons in offshore markets would not count either for the number of U.S. investors in the case of Section 3(c)(1) nor as a U.S. investor that is not a QP in the case of Section 3(c)(7)) not to the number of investors.

	Model Procedures	***Considerations***
	a. Each underwriter represents that it is a QIB/QP. U.S. Investor Letter b. With respect to any sales to U.S. persons in the initial placement, the underwriters will: (i) sell only to QIB/QPs who sign a representation letter containing the representations, warranties and covenants described above under "U.S. Investor Letter," and (ii) deliver such representation letters to the issuer promptly following their receipt by any underwriter. Additional Representations and Warranties c. Any representations and warranties will need to be tailored to include any additional procedures that are adopted, including, for example, any minimum denominations for U.S. sales.	to ensure compliance with Section 3(c)(7). Compliance with the Investment Company Act and other U.S. securities laws are primarily the obligation of the issuer. However, for the purposes of a given transaction an investment bank is considered to be an agent only through the closing date.[26] Therefore, representations and warranties from the investment banks should only need to cover through the closing date (i.e., tracking the period when they would be considered an agent of the issuer for the purposes of Investment Company Act and other U.S. securities considerations).[27] The 2008 Procedures were concerned with the potential for flow-back of securities into the United States as U.S. persons might buy fund securities through the offshore market following commencement of secondary trading. To prevent this, the 2008 Procedures contemplated that the underwriters would follow additional procedures during a 40-day period following completion of the transaction. However, there is no requirement to do so in Rule 3(c)(7) or the relevant no-action letters. Implementation of such a 40-day period is viewed by many as overly conservative and absent a

[26] Investment banks have a particular sensitivity concerning post-completion covenants in order to make it clear when they cease being an agent of the issuer. For compliance purposes an investment bank will usually operate with a divide between its public side and its private side. Since after completion the bank will cease its engagement with the issuer and its activities will end on the private side, this would trigger the end of any "agency" relationship with the issuer and the bank will want to ensure that this ending of its obligations as an "agent" are clearly demarcated.

If, however, there are private engagements post-completion with the same issuer, there may be a suggestion that the bank is still acting as an agent for the issuer and post-completion covenants may be appropriate to consider. In addition, if you are dealing with an investment bank that does not have a clear divide between its private and public operations (e.g., a smaller financial institution or one headquartered in an emerging market), you may also need to explore post-completion covenants and other potential impact(s) on these procedures.

[27] Unlike the Securities Act, the Investment Company Act does not include a definition of the term "underwriter"; therefore, for purposes of the Investment Company Act, an underwriter may be considered an agent of the issuer up to closing of the transaction. As such, when developing appropriate procedures to form the requisite "reasonable belief" for purposes of Investment Company Act compliance, it will, in most cases, not be appropriate to place after-market responsibility on an underwriter.

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		specific set of circumstances in a transaction with an issuer with a high profile in the United States and a high U.S. investor interest, this procedure would not be implemented. The 2012 Commentary recognized that market practice has evolved and "alternative solutions may be appropriate". In addition, market participants have commented that any such 40-day period should only be the responsibility of the issuer to enforce and not the responsibility of the underwriters, who in most cases would have ceased to have any agency status upon completion of the offering. Special thought is required as to how some of the restrictions imposed upon underwriters are intended to work in the context of black box trading systems, whereby a trader and the bank match orders via an electronic trading system against one of a range of possible trading venues and the over-the-counter (OTC) market. These trades may be against offshore regulated markets but there is likely to be no way to verify this.
Subsequent Transfers or Resales by U.S. Persons	Subsequent transfers by a U.S. person (and any other subsequent U.S. transferee) are required to provide a buyer certification to the issuer outside of trading and settlement (typically via the registrar) as part of its Section 3(c)(7) procedures. **U.S. Investor Letter** a. If the transfer is made to a known U.S. person, the transferee would deliver a representation letter (containing the representations, warranties and covenants described above under "U.S. Investor Letter") to the issuer or its registrar, prior to the settlement of the transfer.	Should an issuer feel obligated to make off-market trades available to its shareholders or should it have concerns about its ability to rely on the Goodwin Procter No-Action Letter, it should put in place additional procedures with respect to subsequent transfers and resales by U.S. persons. These procedures are in place to ensure ongoing compliance in the secondary market with Section 3(c)(7), ensuring that future U.S. purchasers are (i) aware of the restrictions in relation to the securities and (ii) QIBs and QPs; or, alternatively, that the trade is a valid Regulation S transaction with a non-

	Model Procedures	***Considerations***
	Non-U.S. Person b. If to a non-U.S. person or an "unknown person": Compliance with Regulation S (i) The sale must qualify as an "offshore transaction" under Regulation S and not have been prearranged with a U.S. person (e.g., a regular-way sale through a non-U.S. stock exchange, not involving an underwritten offering or a block trade). **Exit Letter** (ii) The transferor must deliver an exit letter to the issuer or its registrar, prior to the settlement of the transfer, stating that it is selling in an offshore transaction in accordance with Regulation S.	U.S. person. The 2008 Procedures applied a $250,000 minimum sale amount to subsequent transfers of securities after the initial allocation. The 2012 Commentary noted that such a requirement would not apply in the case of sales to "unknown persons", which should cover non-prearranged trades over the offshore exchange.
Offering Document	**Transfer Restrictions** The offering memorandum should contain a detailed description of the transfer restrictions applicable to the securities being offered, because such restrictions will necessarily be quite comprehensive, compared to the other, relatively unrestricted, securities being traded on the relevant exchange.	The offering memorandum must contain all material information with respect to the terms of the offering and the securities being sold. Therefore, it is necessary to summarize the procedures set in place by the issuer for compliance with Section 3(c)(7) during the offering and in the secondary market. The transfer restrictions also provide notice to the market of the restrictive nature of the securities and the material terms of the securities with respect to resale.
Information Sources (Bloomberg, Reuters, Telekurs)	The 2008 Procedures suggested that the issuer should take the necessary steps to ensure that the information screens of each service that is expected to be an important source of information regarding the offering contain all of the Section 3(c)(7) legends that are available for such service.	This serves as one form of notice to the market regarding reliance on Section 3(c)(7). There are practical difficulties in setting up flags in the news service systems and it may not be possible and is not customary to use this notification route. Where it is practicable and possible, this may complement

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		the notice feature of the Exchange naming convention, although the 2012 Commentary noted that it is generally more common to use the legends for debt securities rather than equity securities.
Initial Distribution for Preemptive Offerings (Rights Issues and Open Offers)	European offerings of this type often take the form of pre-emptive rights offerings, which necessitate the inclusion of an additional step in order to preserve the availability of the exemptions under which the securities will be offered. **Investor Pre-certification as to QIB/QP Status** In the case of a rights issue, each U.S. person to whom a prospectus relating to an offering is to be sent first signs a pre-certification letter containing statements to the effect that it is a QIB/QP, purchasing for its own account, or for the account of one or more QIB/QPs, each of which is acquiring the beneficial interests in the securities for its own account; **U.S. Investor Letter** Each initial U.S. purchaser signs a representation letter containing the representations, warranties and covenants described under "U.S. Investor Letter," which is delivered to the issuer or its registrar.	This provides a foundation for the reasonable belief that U.S. investors are QIBs and QPs, as well as providing assurances for future compliance in the secondary market.