COMMENT: Russian issuers face up to onerous new limits on foreign IPOs

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New Russian foreign listing rules could hike the cost of equity capital for Russia companies at a time when many of them are over-leveraged and starved for equity financing, according to the **Corporate Department of Latham & Watkins in Moscow.**

In June 2009, the Russian Federal Service for the Financial Markets (FSFM) published proposed amendments to its regulations governing the issuance of permits for the placement and/or trading of Russian issuers' shares abroad. The Proposed Regulations are intended to take effect by September 2009.

The current regulations allow the FSFM to issue a permit for up to 30% of each class of the issued and outstanding shares of most Russian issuers. Issuers that are "strategic enterprises" or "subsoil strategic enterprises", as defined in Russian laws governing investment in strategic enterprises, may obtain permits for no more than 25% or 5%, respectively, of each class of their shares. Once issued, a permit does not have an expiration date, and may be utilised at any time in the future by the issuer in connection with a foreign placement of securities.

The proposed regulations would reduce the maximum percentage of each class of the issued and outstanding shares of a Russian issuer that may be circulated outside Russia from the current cap of 30% for most Russian issuers to 25% for such issuers with shares on the "A" quotation list of a Russian stock exchange, 15% for such issuers with shares on the "B" quotation list and 5% for such issuers with shares on the "V" or "I" quotation list. Strategic enterprises which were subject to a 25% cap under the old regime would become subject to the same limitations as other Russian issuers, but the regime applicable to subsoil strategic enterprises is unchanged.

The proposed regulations do not provide for an automatic increase or decrease in the number of shares subject to a permit in the event that the issuer becomes or ceases to be a strategic enterprise or a subsoil strategic enterprise, or if it moves between quotation lists.

Unlike the current regulations, the proposed regulations state that a permit will be cancelled by the FSFM if an offering of the securities to which the permit relates is not completed within one year of the date of the permit.

Many Russian issuers wishing to conduct an initial public offering abroad will only qualify for the "V" or "I" quotation list, but may need to place well over 5% (and at post-crisis valuations, perhaps even more than 25%) of their shares to make an international offering commercially viable.

The new proposed regime aims to restrict domestic companies from running to foreign exchanges and retain fresh equity issuance by Russian blue-chips on domestic exchanges.

The regulations therefore tend to limit the ability of such issuers to access the superior valuations available in the comparatively liquid and transparent international capital markets, and to that extent, the proposed rules would tend to increase the cost of equity capital to Russian issuers at a time when many of them are over-leveraged and starved for equity financing.

Indeed, taken together with the recently enacted amendments to the securities law intended to facilitate the circulation of foreign securities in Russia, the proposed regulations may quite unintentionally have the effect of making it more attractive for Russian groups to establish offshore holding companies for the purpose of raising capital in initial public offerings outside Russia. However, such an approach may be regarded by FSFM as an attempt to evade the proposed regulations.

Accordingly, Russian issuers considering an international equity offering will face an even more challenging regulatory framework than before.

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