

**UPDATE REGARDING RECENT REGULATIONS AFFECTING
ASSET MANAGERS IN FRANCE
AS OF 1 JUNE 2014**

This update sets out a short summary of what we consider to be among the most significant elements of certain recent and proposed French regulatory initiatives occurring over the past year which affect French asset managers.

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This update is for general guidance purposes only, and is not intended to be exhaustive or a substitute for either specific legal advice or internal compliance control obligations.

Transposition of the AIFM Directive in France

Thanks to a flurry of legislative and regulatory activity in late July and early August last year, the Alternative Investment Fund Managers Directive (AIFMD or the Directive) was implemented in France just after the July 22 deadline. Though there remain certain inconsistencies and grey areas, the modifications made to existing French laws and regulations since then have resulted, for the large part, in a faithful transposition of the Directive as well as a number of modernisation measures intended to increase the competitiveness of French funds.

The revised texts are summarized below:

- **Order n° 2013-676 of July 25, 2013** (modifying the legislative part of the French Monetary and Financial Code) and **Decree n° 2013-687 of July 25, 2013** (modifying the regulatory part of the French Monetary and Financial Code)

- Together, these changes to the Monetary and Financial Code work to modernize the French framework and range of funds, by renaming, reorganizing and merging funds in order to simplify and better align French funds with offerings in other European jurisdictions.
- These changes to the French range of funds and other modernization measures were summarized and explained in a guide published by the AMF on July 12, 2013, and are reflected on the table on the next page.
- Note that French asset managers may apply for management and marketing passports to provide services in other EU member states as soon as they comply with AIFMD.
- Note also that the revised text has already pre-transposed provisions of the Directive relating to third country passports which are not yet effective, and are in fact conditional on ESMA's opinions in 2015 and 2018.

UCITS (OPCVM) (L 214-1 I 1° and section I)	FUNDS GOVERNED BY THE AIFM DIRECTIVE – AIFs (FIA) (L 214-1 I 2° and section 2)					OTHER COLLECTIVE INVESTMENTS (L 214-1 I 3° and section 3)
f.k.a. coordinated UCITS (OPCVM coordonnés)	Funds open to non-professional (retail) investors	Funds open to professional investors	Employee savings funds	Securitisation vehicles (OTs)	Other AIFs	Funds described in section III
General vocation investment funds f.k.a. <i>general vocation funds under L 214-27</i>	Authorized funds	1) General vocation professional funds f.k.a. <i>OPCVM ARIA</i>	f.k.a. <i>FCPE and SICAVAS</i>	OT without insurance risk	AIF described in L 214-24 III which the AMF deems to be "AIF by object" <u>These funds are NOT considered to be OPC</u>	SICAV and SPPICAV closed SASU (i.e: funds that can have just one shareholder)
Private equity funds (FCPR + FCPI + FIP)	2) Professional real estate funds (OPPCI) f.k.a. <i>OPCI RFA EL</i>	2) Professional real estate funds (OPPCI) f.k.a. <i>OPCI RFA EL</i>		OT with insurance risk		
OPCI (real estate funds) f.k.a. <i>OPCI et OPCI RFA SEL</i>	Declared funds	1) Specialized professional funds f.k.a. <i>contractual funds and contractual FCPR</i>				
SCPI (real estate funds)	2) Professional private equity funds f.k.a. <i>FCPR allégés</i>					
SEF (social entrepreneurship funds)						
SICAF (closed, fixed capital funds)						
Alternative funds of funds f.k.a. <i>OPCVM de fonds alternatifs (societal or fund form)</i>						
COLLECTIVE INVESTMENT UNDERTAKINGS (OPC) (L 214-1 II) (denomination which tracks established notion of OPCs)						

Note that the modifications outlined above apply to all new funds launched after July 23, 2013, while funds existing prior to that date have until July 22, 2014 to comply by changing their denomination to match one of the new product categories.

- ↘ **Decree of July 25, 2013** (relating to entities that may carry out depositary activities)
 - Modifies the Decree of September 6, 1989 relating to depositaries by adding a section II to Article 1 relating specifically to AIF depositaries. In addition to the types of entities already allowed to act as depositaries for UCITS in France (i.e. French banks, investment firms authorized to carry out custody activities, and insurance companies), AIFs may have as their depositaries branch offices of authorized European credit institutions and investment firms (as provided in Article 21(3) of the Directive).
- ↘ **Order of August 8, 2013** (modifying **Book III of the AMF General Regulations**, relating to Service Providers):
 - The modifications create a new chapter 1 bis, relating to asset management companies of AIFs, and chapter III bis, relating to depositaries of AIFs.
 - The changes also add provisions relating to the resignation of AIF management companies, specific rules regarding non-French AIFM (including, confusingly, rules regarding non-EU passports which will not come into force until at least 2015 and 2018, subject to ESMA's opinion), delegation and remuneration rules, all in accordance with the provisions set out in the Directive.
 - In addition, numerous cross-references are made, where applicable, to relevant provisions of the Delegated Regulation (EU) 231/2013 of December 19, 2013, which is directly applicable in France.
 - Overall, changes are largely semantic, aside from certain clarifications relating to real estate fund fees. Further modifications to Book III are expected in the future.
- ↘ **Order of December 20, 2013** (modifying **Book IV of the AMF General Regulations** relating to Products):
 - The modifications create a new Title II relating to AIFs, covering marketing, asset valuation and information to be provided to investors and regulators, all essentially as set out in the Directive. This new Title II is organized as follows:
 - **Chapter I: general provisions** relating to all AIFs: marketing of non-French funds in France (note, however, that an AMF Instruction on marketing of AIFs is still pending), valuation rules and investor and regulator information requirements. Note that marketing rules applicable to AIFs in France are essentially identical to those previously applicable to UCITS.
 - **Chapter II: funds open to non-professional (retail) investors** including general vocation funds, private equity funds (FCPR, FCPI, FIP) and real estate funds (OPCI, SCPI).
 - **Chapter III: funds open to professional investors only**, broken down into:
 - funds requiring AMF authorization -- general vocation professional funds and professional real estate investment funds (OPPCI)
 - funds simply requiring AMF notification ("declared funds") -- specialized professional funds and professional private equity funds
 - **Chapter IV: employee savings funds**
 - **Chapter V: securitization vehicles (OTs)**
 - As expected, Book IV now incorporates simplified subscription thresholds for AIFs, providing for just two thresholds (100 000 Euros for AIFs open to professional investors, and 0 Euros for AIFs available to retail investors).

In order to fully implement the Directive, the AMF has issued a number of Positions, and has updated its Instructions, in order to provide necessary details relating to AIFMs and AIFs. On April 28, 2014 it also provided (in English) a summary of its assistance for market participants applying for AIFM approval in France, including updates on its transposition activity and the status of bilateral cooperation agreements entered into with regulators of non-European alternative investment fund managers (including, inter alia, Switzerland, Japan, the Cayman Islands, BVI, Bermuda and the United States Federal Reserve Board, SEC, OCC and CFTC).

↘ **On January 10, 2014, the AMF published updated versions of the following existing Instructions,** essentially extending the scope of such rules to AIFs:

- **Instruction 2008-03** – rules regarding authorization of portfolio management companies, AIF management passports and information requirements
- **Instruction 2008-04** – good conduct rules regarding the marketing of UCITS and AIFs
- **Instruction 2011-15** – modalities for calculating global risk of UCITS and authorized AIFs

↘ **On February 21, 2014 Instruction 2012-01** (relating to the management of risk by portfolio managers) was also updated to take into account the new fund classifications resulting from the AIFMD transposition.

↘ **Position 2013-22 (AMF Questions and Responses regarding AIFMD transposition in France):**

- Originally published on November 18, 2013, this formal Position essentially sets out a number of “frequently asked questions” and the AMF’s responses thereto, and is intended to be updated regularly.
 - Topics in the initial Position include authorization as a portfolio management company vs “simple” registration, absence of reporting obligations for delegates and requirements relating to thresholds for declarations of major shareholdings/changes of control
 - On March 19, 2014, the Position was updated to four new Q&As:

- CIFs advising venture capital firms need not apply for AIFM authorization
- Transitional provisions for closed ended funds
- Availability of information regarding AIFM authorization status on the AMF website at <http://www.amf-france.org/Recherche-avancee.html?formid=GECO>
- Ability of entities managing “other AIFs” having retail investors opting to be treated as professional to use registration procedure rather than applying for authorization

↘ **On May 23, 2014, the AMF published revised versions of the following product-related Instructions,** essentially updating the rules regarding creation of such funds and prospectus/KIID, investor information and periodic reporting requirements to reflect the new nomenclature applicable to French AIFs:

- Instruction 2011-20 (FIA FIVG; funds of AIFs and general professional funds)
- Instruction 2011-21 (employee savings funds: FCPE and SICAVAS)
- Instruction 2011-22 (Private equity funds)
- Instruction 2011-23 (Real estate funds)
- Instruction 2012-06 (Declared funds)

↘ **A final AMF instruction relating to the marketing of AIFs** is still pending, and expected to be issued by the fall of 2014.

↘ **Good practices regarding mechanisms for improving liquidity (swing pricing / ADL)** have been drafted by the AFG (the French asset management association) and are currently under discussion among the AMF, the AFG and other professional associations. Once adopted and published by the relevant professional associations (in particular the AFG), swing pricing and anti-dilution levy mechanisms will be available – on an optional basis – for both AIF and UCITS managers. Managers opting to use such mechanisms will likely have to provide specific information to investors, and allow investors to redeem without cost if the level of subscription or redemption fees will be increased as a result.

↳ ESMA Guidelines adopted by the AMF

On August 14, 2013, the AMF issued Position 2013-11, integrating ESMA's **Guidelines on sound remuneration policies under the AIFMD** (published by ESMA on February 11, 2013). This Position was preceded by an AMF Guide, published on August 2, intended to assist asset managers in understanding and applying the remuneration rules, which in certain cases should be applied with careful consideration to French labor law requirements.

On October 13, 2013 the AMF issued Position 2013-16 adopting ESMA's **Guidelines on key concepts of the AIFMD** (published by ESMA on May 24, 2013).

We also note that, on November 15, 2013, ESMA issued final Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD. Once translated into the official EU languages and published on the ESMA website, the AMF will have a two-month period during it must notify ESMA whether it complies or intends to comply with the guidelines.

Other AMF rulemaking

Despite the volume of work involved in the AIFMD transposition since July 2013, the AMF has also managed to issue a handful of new and updated non-AIFM specific rules.

↳ Inducements

On July 10, 2013, the AMF published **Position-Recommendation 2013-10** regarding inducements received in the course of marketing financial instruments and management mandates.

Intended to complete and clarify the AMF's consultation issued on June 7, 2012, this new Position-Recommendation essentially repeats guidance that is already well established with regard to inducements in France:

- Gifts given to staff members by a third party and remuneration paid to employees is not subject to inducement rules (but are subject to conflict of interest rules) ;
- When an investment service provider who provides an issuer with firm commitment or placement services also carried out the distribution of securities to final investors, the remuneration received from the ISP from the

issuer will belong to the second category (fees, commissions or non-monetary benefits paid or provided to or by a third party or a person on behalf of a third party), and thus must satisfy the following conditions:

- clear prior disclosure must be given to the firm's client; and
- the payment of such fees must be designed to enhance the quality of the relevant service to the client and may not impair compliance with the firm's duty to act in the client's best interests

This is helpful clarification, as it could be assumed that the remuneration falls instead in the first category (fees, commissions or non-monetary benefits paid or provided to or by the client or a person on behalf of the client), given that the ISP's client is both the issuer and the investor.

- Inducements that correlate to a market risk are not subject to regulation. In other words, inducement rules will not apply to (i) remuneration for firm commitments, constituting the difference between the final sale price to investors and the issuance or transfer price, or (ii) remuneration paid for guaranteed placements addressed principally to non-retail clients. Again, this is helpful clarification given that the texts include no such exception.

- ↳ **Law n° 2013-672 of July 26, 2013** : allocates responsibility for overseeing EMIR compliance between the AMF and the French banking regulator (the *Autorité de Contrôle Prudentiel et de Résolution*, or ACPR). In summary, the AMF will be responsible for oversight of central clearing and trade reporting obligations, regardless of the types of counterparties involved. However, with regard to risk mitigation techniques and requests for exemptions (for trades within the same group), the ACPR will oversee compliance by credit institutions not providing investment services and insurance companies, while the AMF will have responsibility for asset management companies and non-financial entities. The ACPR and AMF will coordinate supervision of investment providers and credit institutions that provide investment services, as both regulators share competence over these entities.

- **Decision of September 18, 2013** : modifies four articles of the AMF General Regulation to clarify that investment service professionals, acting on behalf of a client to which it provides portfolio management services, may purchase shares of funds reserved for qualified investors, regardless of the status of the underlying investor.
- A trio of **AMF Positions , all issued on September 20, 2013**, update prior Positions relating to the marketing of complex, structured or guaranteed products to retail investors.

 - **AMF Position 2013-12**: allows marketing of formula or “guaranteed” UCITS or AIFs, as well as structured products having similar characteristics, to retail investors only if the relevant guarantee (of the formula, or of initial capital, as the case may be) is provided by an entity subject to prudential rules similar to those applicable in France. In this event, such products may be marketed to French retail investors without any particular warnings, subject to applicable rules.
 - **AMF Position 2013-13**: sets out a guide for drafting marketing documents relating to structured debt securities, based largely on the similar guide issued by the AMF for funds (Position-recommendation 2011-24) and the requirements of the MIFID and Prospectus Directives.
 - **AMF Position 2010-05**: sets out marketing rules relating to the marketing of complex debt securities and formula funds to retail investors,
- **AMF Instruction 2012-02 published November 20, 2013** – clarifies services that assist in investment decision and order execution.
- **AMF Guide regarding the marketing of foreign UCITS, published on December 24, 2013** – summarizes existing rules regarding the marketing of non-French UCITS in France.
- **Decree of January 30, 2014** – opens possibility of admission to trading on regulated markets to non-index UCITS and AIFs, provided such funds are traded at NAV (adjusted to take into account issuance/redemption fees).
- **Instruction 2011-19 published February 21, 2014** – clarifies rules applicable to the creation of a French UCITS, modifications during the life of the UCITS and modalities for providing information to investors and the AMF.

AMF disciplinary action

A decision **published on July 8, 2013 against “Company X”**, a sizable asset management company belonging to a large group, related to the use of a group cash pooling arrangement and the resulting control of the company’s regulatory capital by other group companies, in violation of its program of operations (*programme d’activité*) and relevant laws and regulations.

As noted in Company X’s program of operations, cash held by Company X was pooled at the group level pursuant to a cash pooling arrangement. The program of operations went on to state that Company X would nevertheless retain control of its pooled amounts.

However, the AMF found that in fact, restitution of such amounts upon first demand was not certain, and the control of the integration and restitution of Company X’s cash was in practice controlled by the direct and indirect parent companies of Company X (i.e. its shareholders). At certain points during the period examined, Company X’s available regulatory capital had fallen below the relevant requirements, with cash restored only after specific request by the AMF General Secretary.

Although the cash pooling arrangement was described in Company X’s program of operations, the AMF held that the manner in which the cash pooling was put into practice – essentially giving Company X’s shareholders control over its capital – should have been notified to the AMF as a change in a “characteristic element” of its authorization. In this regard, it should be noted that “characteristic elements” giving rise to AMF notification are set out in AMF Instruction no. 2008-03, and do not include issues relating to the management of treasury and regulatory capital.

However, the AMF found that the parent companies' actions in implementing the cash pooling was incompatible with Company X's undertaking to preserve control of cash that was pooled, and that this resulted in a substantial modification of the paragraph of the program of operations relating to human resources. Accordingly, Company X should have immediately notified the AMF as to its shareholders' actions, as required by article 311-3 of the AMF General Regulation.

The AMF also found that Company X's use of the cash pooling arrangement violated legal and regulatory provisions relating to the management of its regulatory capital.

However, taking into consideration that Company X had immediately modified its treasury management procedures upon receiving its first letter from the AMF General Secretary, the AMF imposed a relatively low fine of 100,000 Euros on Company X.

In two decisions handed down at the end of July 2013, the AMF sanctioned a large French bank with fines of 280,000 Euros and 500,000 Euros, respectively.

In the first **decision, dated July 25, 2013**, large French bank acted as both asset manager of an FCP and collateral manager for USD 10 million of collateralized debt obligations which were part of the fund. The AMF found that providing – and being paid for – both services was contrary to the interests of investors, and thus a violation of its obligations relating to the management of conflicts of interest.

The second **decision, dated July 29, 2013**, involved a large French bank in its capacity as depositary for 124 asset managers, representing over two thousand funds. The AMF found that the bank had not provided sufficient human resources and procedures to the depositary's audit department, which had between two and four agents during the period in question. As a result, the bank was unable to appropriately audit and evaluate internal organization of the asset managers for which it acted as depositary. Further, the AMF found that the bank did not have adequate IT resources given its considerable depositary activity.

In a **decision published on August 6, 2013**, the AMF found that "Company X", a credit establishment regulated by the French banking regulator, the ACP (now known as the ACPR), failed to include appropriate legends clearly indicating that certain documents and brochures were promotional materials, as required by article L. 533-12 of the Monetary and Financial Code and article 313-25 of the AMF General Regulation. Further, such materials failed to sufficiently warn of the high risk associated with the complex financial products being marketed, rendering the information provided in the brochures inaccurate, if not misleading, in violation of article L. 533-12 of the Monetary and Financial Code and article 314-11 of the AMF General Regulation.

In this regard, the AMF noted that Company X's brochures failed to mention the volatility and liquidity of the securities underlying the complex financial products being marketed, and that legal warnings regarding the possibility of losing more than the initial investment were in tiny, almost unreadable type on the back of the document, whereas the potential for large gains was more prominently displayed in regular-size type.

The AMF was nevertheless relatively lenient in imposing a mere 30,000 Euro fine on Company X, taking into account its recent arrival in France at the time of the AMF review, as well as its prompt action to revise the brochures to address the AMF's points upon being notified of the potential violations.

A decision dated December 5, 2013 dealt with the need for an asset management company that is part of a group and uses complex derivatives to have autonomy. The AMF noted that a parent company that acts as financing and investment bank may also be the sole counterparty for its subsidiary, provided that the asset management company develops its valuation models independently.

In the case at hand, charges were brought against an asset management company belonging to a banking group for not having organized its human and material resources in accordance with its program of operations, for having insufficient internal control and compliance programs as well as risk assessment programs linked to the valuation of complex derivatives.

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