



# PRACTICAL LAW

MULTI-JURISDICTIONAL GUIDE 2012

## INVESTMENT FUNDS

The law and leading lawyers worldwide

Essential legal questions answered  
in 22 key jurisdictions

Rankings and recommended  
lawyers in 30 jurisdictions

Analysis of critical  
legal issues

Top 10 global firms  
identified



# France

Stéphane Puel and Arnaud Pince  
Gide Loyrette Nouel

[www.practicallaw.com/5-501-4693](http://www.practicallaw.com/5-501-4693)

## RETAIL FUNDS

### 1. What is the structure of the retail funds market? What have been the main trends over the last year?

#### Open-ended retail funds

The amount of French assets under management decreased by 3.2% during the first nine months of 2011 to EUR2,651 billion at the end of August 2011 (just below the 2009 level) (*Association française de gestion financière, Marché français de la gestion financière en 2011*), encompassing discretionary investment management and collective investment (as at 1 November 2011, US\$1 was about EURO.7).

This decrease in the amount of assets under management is particularly significant for French OPCVMs (-7.1% in fund raising), whereas the value of assets under management of discretionary mandates remain stable. There are currently more than 600 portfolio management companies licensed by the *Autorité des marchés financiers* (AMF), and more than 30 new asset managers were licensed by the AMF during the first nine months of 2011.

Asset management companies are divided into two categories: subsidiaries of banking groups or other financial groups (including insurance) and entrepreneurial companies. Entrepreneurial companies represent more than one-half of all management companies, but only 5% of total assets under management. However, the subsidiaries of banking groups represent one third of management companies, but almost two thirds of total assets under management. In ten years, the number of French management companies almost doubled.

The French investment fund industry also has various smaller niche management companies, notably for hedge funds, multi-managers' funds and private equity funds.

#### Closed-ended retail funds

The *société d'investissement à capital fixe* (SICAF) is the only existing legal form of closed-ended fund in France. Its legal regime, which had not been subject to any major amendments since 1945, was significantly updated by an Order dated 30 January 2009 (*Order 2009-107*). SICAFs are now listed in the Financial and Monetary Code as undertakings for collective investment. However, this reform was implemented in France during the global financial crisis and closed-ended retail funds are currently almost non-existent in France compared to Anglo-Saxon countries. This should change in the next few years.

Further and more generally, venture capital funds, although formally open, are intended to be held to maturity.

## Regulatory framework and bodies

### 2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

#### Open-ended retail funds

**Regulatory framework.** The main provisions regulating retail funds are the:

- French monetary and financial code (*code monétaire et financier*) (Code).
- General Regulations of the AMF (*règlement général de l'AMF*) (General Regulations), the French financial markets and securities authority (*see below*).
- Conduct of business rules issued by the AFG, the French asset management association, which represents investment funds and investment management companies.

In addition, general French civil and commercial rules also apply to retail funds.

**Regulatory bodies.** French funds (*organismes de placement collectif en valeurs mobilières*) (OPCVM) and management companies (*sociétés de gestion de portefeuille*) (SGP) are regulated by the AMF. The AMF is an independent public authority (that is, it has its own financial resources and its own employees) established by the Financial Security Act (*Law No. 2003-706 of 1 August 2003*).

The AMF's duties include:

- Safeguarding investments in financial instruments and in all other savings and investment vehicles.
- Ensuring that investors receive correct and precise information.
- Maintaining orderly financial markets.

In the performance of its duties, the AMF can (among other things):

- Adopt and implement its General Regulations, and its implementing instructions and recommendations.
- Grant individual authorisations such as licences for SGPs (*see Question 3*).
- Carry out inspections and investigations.
- Impose sanctions and penalties for breaches of regulations or professional obligations.



The General Regulations determine the conditions of authorisation and conduct of business rules applicable to SGPs.

The AMF authorises the setting-up of OPCVMs, during which they:

- Check that the OPCVM complies with all legal and regulatory requirements.
- Examine the key information set out in its prospectuses.

The AMF subsequently monitors each OPCVM through its life-time, paying particular attention to the information disclosed to investors (such as marketing materials).

Non-retail funds are regulated and supervised in the same way as retail funds (*see above*).

### Closed-ended retail funds

**Regulatory framework.** Similar rules and regulations apply as for open-ended funds, including the Code and the General Regulations (*see above, Open-ended retail funds*).

**Regulatory bodies.** *See above, Regulatory framework.*

---

## 3. Do retail funds themselves have to be authorised or licensed?

---

### Open-ended retail funds

All open-ended retail OPCVMs must apply for and receive a licence from the AMF before they begin marketing. The AMF grants the licence to French OPCVM within one month of the OPCVM making its application if no problems arise.

The AMF can suspend the procedure until the SGP submits a supplementary information sheet. Failure to do so within 60 days may result in the application being rejected.

For foreign funds regulated by the Directive 2009/65/EC on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (UCITS IV Directive) the passport procedure has been simplified following the implementation of the UCITS IV Directive under French law. Under the simplified regulator-to-regulator notification procedure, the notification file is transmitted by the home regulator to the AMF and the passport is effective upon that transmission.

### Closed-ended retail funds

The setting up of SICAFs is not in itself subject to the prior approval of the AMF, but SICAFs must submit a prospectus to the regulator for any offerings of securities to the public or for listing on a regulated market.

### Marketing

---

## 4. Who can market retail funds?

---

### Open-ended retail funds

Solicitation activities in relation to funds were traditionally regulated and had to be performed by a regulated entity or another entity acting on behalf of a regulated company.

Following the implementation of Directive 2004/39/EC on markets in financial instruments (MiFID) on 1 November 2007, the marketing of funds has become a regulated activity amalgamated in certain circumstances with the investment service of advice, notably in cases of complex products and reception and transmission of orders (when not performed by the management companies of the funds or the custodians). This makes the marketing of funds restricted to investment services providers.

Financial investment advisers are also able to market funds under their existing licence.

Similar rules apply to a foreign fund which has received the AMF authorisation to be marketed in France.

### Closed-ended retail funds

Similar rules apply as for open-ended retail funds (*see above, Open-ended retail funds*).

---

## 5. To whom can retail funds be marketed?

---

### Open-ended retail funds

Any type of investors (individuals or legal entities) can subscribe to units or shares of OPCVMs with a general purpose, subject to any limitations in the fund's prospectus (such as a minimum amount). In particular, subscription to OPCVMs may be restricted to a specific category of investors whose characteristics are precisely defined in the prospectus, such as participants of a given life insurance contract or entities of a specific group of companies (*Article 411-22, General Regulations*).

Similar rules apply to a foreign fund which is authorised for marketing in France by the AMF.

### Closed-ended retail funds

A SICAF cannot offer securities to the public unless the value of each share of the SICAF is higher than EUR10,000 (*Article L. 214-151 and D.214-240, Code*). The purpose of this rule is to provide for minimum subscription amounts, such as the ones existing for certain OPCVMs (*see above, Open-ended retail funds*).

If the price of the share is lower than EUR10,000, the shares of the SICAF cannot be subject to any financial solicitation (*démarchage*), unless the targeted investors fall within the category of qualified investors as defined in Article L. 411-2. II of the Code.

### Managers and operators

---

## 6. What are the key requirements that apply to managers or operators of retail funds?

---

### Open-ended retail funds

SGPs are licensed by and, under the supervision of, the AMF.

**Licensing requirements.** The following requirements apply to SGPs (*Article L. 532-9, Code and AMF Instruction 2008-03*):

- The SGP's registered office must be in France and its legal form must be suitable for its activities.

- The SGP's initial capital must be fully paid up and at all times its own funds (*fonds propres*) must be a minimum of the larger of either:
  - EUR125,000;
  - one-quarter of its overheads.
- The SGP's activities must remain within the scope of its licence, which can be extended over time.
- Unless specific circumstances apply, the SGP must be managed by at least two directors, both of whom are responsible to the AMF for its effective management. Non-French nationals may be appointed, provided they:
  - are French residents;
  - speak French;
  - have a professional knowledge of the French financial markets and financial regulations.
- At least one of the two responsible managers must work full time within the SGP.
- The management team must comprise at least two persons working full time within the SGP (who can also be the two above mentioned directors of the SGP).
- A compliance officer must be appointed to manage internal controls and ensure compliance with conduct of business and fair practice rules (*Article 313-66, General Regulations*). Small SGPs can outsource compliance to a third party.

**Supervision requirements.** The General Regulations set out conduct of business rules and professional obligations for SGPs.

The AMF can perform on-site inspections to ensure that SGPs work within the programme of activities allowed by the AMF licence. The AMF also ensures compliance with, among other things, organisational requirements, Chinese wall rules and internal control provisions.

These requirements are supplemented by professional organisations' codes of good conduct. Professional organisations must submit their codes to the AMF, which can approve all or part of them as professional standards. SGPs must join one professional association when licensed.

**Organisation rules.** Since the implementation of MiFID (see *Question 4*), Articles 313-1 to 313-78 of the General Regulations set out organisational rules that each SGP must comply with:

- A process for each activity to ensure it complies with the conditions and obligations derived from its licence or its professional duties.
- A process for listing any activities from which a conflict of interest with the clients' best interest may arise. This process must be suitable to the size of the company and its activities.
- Reasonable measures to maintain its activity, when outsourcing critical tasks.

At present, French OPCVM must be managed by a French asset management company. However, the management company

passport provided for in the UCITS IV Directive will enable asset management companies authorised in their home member state to manage funds in other member states without being established in such countries.

#### Closed-ended retail funds

As for open-ended funds, a SICAF must be managed by a duly licensed management company (*Article L. 214-149 of the Code which refers to Article L. 532-9 of the Code*). Similar rules therefore apply (see above, *Open-ended retail funds*).

#### Assets portfolio

#### 7. Who holds the portfolio of assets? What regulations are in place for its protection?

##### Open-ended retail funds

The OPCVM's assets must be entrusted with a depository (*dépositaire*) who has three main functions:

- Acting as custodian of the assets. The custodian is liable for the safekeeping of the OPCVM's assets and must certify an annual inventory of its assets. As confirmed by recent case law, the depository remains liable even where it delegates this function to a third party.
- Ensuring that the SGP's decisions comply with the Code and the fund's articles of association or regulations.
- Executing subscriptions and redemptions of shares or units of the OPCVM.

The depository must be duly authorised in France by the *Autorité de contrôle prudentiel* (one of the principal financial services regulators in France) and it is prohibited for the same company to act as depository and SGP.

##### Closed-ended retail funds

The assets of a SICAF must be entrusted with an investment service provider duly licensed to provide the investment service of custody (*conservation d'instruments financiers pour compte de tiers*) (*Article L. 214-150, Code*). The name of the service provider must be indicated in the articles of incorporation of the SICAF.

The service provider must be independent from the SICAF and its management company and must act only in the interest of shareholders. The functions of this service provider were specified in a decree dated 20 September 2010 (*Decree No. 2010-1100*). He must ensure the compliance of the decisions of the SICAF and of the management company with the legal provisions.

In relation to his safekeeping duties, he is, like a depository of an OPCVM, responsible for:

- Keeping the custody (*la tenue de compte conservation*) of the financial securities, except for pure registered financial instruments.
- Keeping an official record of the assets of the SICAF, other than the financial securities outlined above and pure registered financial instruments.



### Legal fund vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

#### Open-ended retail funds

**Legal vehicles.** OPCVMs can adopt two different legal forms:

- **Société d'investissement à capital variable (SICAV).** These are open-ended investment companies regulated in part by the general rules applicable to limited liability companies (*sociétés anonymes*). Their capital is divided into shares, which are issued and repurchased at their net asset value on the shareholders' request. Duly licensed portfolio management companies generally manage SICAVs under an investment management agreement. However, a SICAV may be self-managed (that is, managed by its board of directors or directorate).
- **Fonds commun de placement (FCP).** These are unit trusts and are now the most common form of OPCVMs found in the French market. Their assets are divided into units. An FCP (which is not a legal entity) is established by an SGP, which manages its assets and represents them in relation to third parties, and a depository.

A SICAV is regulated by a chairman and a board or directorate, elected by the general meeting of shareholders or supervisory board. An FCP is entirely dependent on its SGP.

Interests held by participants in a SICAV are called shares (*actions*) and interests held in a FCP are called units (*parts*).

Running a SICAV is more expensive and the board's involvement in investment policy can conflict with its role of investment adviser.

**Advantages.** FCPs are the most common form of OPCVMs found in the French market.

**Disadvantages.** Running a SICAV can be more expensive than running a FCP, and the board's involvement in investment policy can conflict with its role of investment advisor.

#### Closed-ended retail funds

**Legal vehicles.** A SICAF can only take the legal form of a limited liability company (*société anonyme*) (*Article L. 214-147, Code*). Therefore, the provisions concerning limited liability companies in the Code apply, with some exceptions.

**Advantages.** The most significant difference between limited liability companies and SICAF is that a SICAF can, at any time, increase its capital without having to comply with all the procedures required for limited liability companies. The only limitation is that when shares are issued at a price which is lower than the net asset value per share, the existing shareholders have a priority right if they wish to subscribe.

**Disadvantages.** The minimum initial capital of a SICAF can not be less than EUR8 million.

### Investment and borrowing restrictions

9. What are the investment and borrowing restrictions on retail funds?

#### Open-ended retail funds

The ratios applicable to UCITS and non UCITS funds are different. There are further multiple ratios in relation to retail funds, including:

- The diversification ratios (5:10:40) (that is, no more than 10% of the fund's property can be invested in transferable securities or money market instruments of the same issuer, and each of the fund's holdings in single issuers that exceed 5% of the fund's property cannot cumulatively exceed 40%).
- The borrowing ratios (10% per issuer).

Retail funds may be undertakings for collective investments in transferable securities (UCITS) funds or non-UCITS funds. When retail funds are UCITS funds, the requirements applicable to UCITS funds also apply.

#### Closed-ended retail funds

There are no legal or regulatory investment restrictions. The board of directors must determine the investment strategy it intends to pursue.

However, the Code does provide for a principle of risk diversification (*Article L. 214-147, Code*). A SICAF can invest all or most of its assets in one fund. However, that target fund must comply with the principle of risk diversification.

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

#### Open-ended retail funds

**Subscription.** Managers can restrict the subscription of shares to a category of investors whose characteristics are precisely defined in the prospectus.

In addition, French OPCVMs can stop issuing units definitely or for a temporary period in objective situations defined in the prospectus of the OPCVM such as (*Article L. 214-7-4 and L.214-8-7, Code and Article 411-20, General Regulations*):

- A maximum number of shares or units issued.
- A maximum amount of assets.
- The term of an allotted subscription period.

**Redemption.** For SICAVs (*Article L. 214-7, Code*) and FCPs (*Article L. 214-8, Code*), shares or units can be redeemed by the OPCVM at any time on request of the shareholders or unitholders.

However, a SICAV or FCP can temporarily suspend redemption of shares or units under its articles of association or internal regulations if both:

- There are exceptional circumstances.
- It is required for the unitholder's or shareholder's best interests (*Article L.214-7-4, Code, Article L.214-8-7, Code and Article 411-20, General Regulations*).

The SGP must notify the AMF of the reasons and procedures for suspending redemptions (*Article 411-20, General Regulations*).

In addition, the redemption of units is suspended when the assets of a FCP or SICAV fall below EUR300,000.

#### Closed-ended retail funds

**Subscription.** A SICAF cannot issue any new shares after the initial subscription period, unless there is an increase of the share capital. After the initial subscription period, an investor can acquire the SICAF's shares on the secondary markets.

**Redemptions.** The shares of a SICAF cannot be redeemed at the request of the investors, except in certain exceptional cases provided for in the SICAF's articles of incorporation (*Article L. 214-147, Code*). Subject to these limited exceptions, an investor can only sell shares on a secondary market.

Listed SICAFs can redeem up to 10% of their capital per year and up to 25% if the price of the shares is 10% less than the net asset value of the shares (*Article L. 214-158, Code*). A general meeting of the SICAF can further authorise the redemption of more than 25% of the shares of the SICAF.

Fixed-term subscription periods may be imposed on FCPIs and structured funds. A lock-in period of ten years may also be imposed on unitholders in FCPIs.

---

### 11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

---

#### Open-ended retail funds

Shares or units of OPCVMs can be sold to other unitholders or shareholders, or to third parties. In this last case, the third party must pay at least the minimum subscription amount, as indicated in the prospectus (*AMF Instruction 2005-02 of 25 January 2005*). However, no active secondary market exists in relation to shares or units of funds, except as to index funds (trackers).

#### Closed-ended retail funds

Non-listed SICAFs can impose restrictions on transfers, for example, approval clauses or pre-emption rights. Listed SICAFs cannot impose restrictions.

#### Reporting requirements

---

### 12. What are the general periodic reporting requirements for retail funds?

---

#### Open-ended retail funds

**Investors.** An OPCVM must:

- Publish a biannual report of the funds' assets. Within six weeks of the end of each half-year of the accounting period, each SICAV (through its board of directors or directorate) and FCP (through its management company) must prepare an inventory of the assets it manages under the depository's supervision. The inventory must be published within eight weeks of the end of each half-year of the accounting period.

- Publish annual accounts at the end of each financial year, including an inventory of the assets and liabilities under management of the OPCVM. The annual financial statements of the OPCVM must be drawn up by the SGP managing the FCP or by the board of the SICAV.
- On request, issue any of the above information to unitholders or shareholders.
- Publish its profit and loss account, and its balance sheet, at least 30 days before the general meeting convened for approval.
- Update the fund's prospectus each year with the latest annual performance report, actual to total expense ratio, and portfolio turnover.

There are specific provisions relating to periodic information that must be given to investors when there are changes in the functioning of an OPCVM.

**Regulators.** SGPs must file an annual information questionnaire relating to the composition of their turnover. The compliance officer (*responsable de la conformité et du contrôle interne*) may also have to file an annual report with the regulator on a specific issue chosen by the regulator.

The net asset value must be sent to the AMF on the same day as it is determined.

#### Closed-ended retail funds

**Investors.** A SICAF must publish within eight weeks following the end of each half-year:

- The composition of the assets.
- The net asset value.
- A report on the fund's exposure to financial risks.

**Regulators.** A listed SICAF must submit a monthly report to the AMF listing all its acquisitions, sales, cancellations and transfers. This information must also be published quarterly.

#### Tax treatment

---

### 13. What is the tax treatment for retail funds?

---

#### Open-ended retail funds

**Funds.** As FCPs do not have any legal personality, they are not liable to corporate income tax (CIT). The income distributed by an FCP is taxed at investor level. SICAVs fall within the scope of CIT, but they benefit from a full tax exemption.

**Resident investors.** Individual investors are subject to income tax on distributions received from an FCP or a SICAV. Individual investors are taxed as if they had directly received the distributed income (that is, with the benefit of the tax relief that usually applies to the different types of income distributed by the fund, such as dividends, interest, and so on). Capital gains realised on the sale or redemption of shares or units are taxable at a rate of 32.5% (including social levies).



French companies subject to CIT are generally taxed on a mark-to-market basis (that is, on the difference between the net asset value of their shares or units at the beginning of the tax year and at the end of the tax year). The regular CIT rate is 33.33%. An additional social contribution of 3.3% is due by certain companies whose CIT exceeds EUR763,000, resulting in an overall CIT rate of 34.43%.

As an exception, corporate investors are not taxed on a mark-to-market basis when more than 90% the fund's assets are shares issued by companies registered in an EU member state and subject to CIT or an equivalent tax.

**Non-resident investors.** As FCPs are transparent for tax purposes, income that they allocate to non-residents keep their qualification and source. Distributions may therefore be subject to a withholding tax in France, at a rate depending on the nature of the income, the source of the income and the country of payment of the income (from 0% for foreign source income and French source interest, to 15% to 25% for French source dividend income and 50% on French source income paid in non-co-operative jurisdictions).

The same regime applies to the distribution made by a SICAV, following a change in the position of the French tax authorities which had previously considered that they constituted dividends for tax purposes.

Capital gains realised by non-resident investors on the sale or redemption of their shares or units are generally not subject to withholding tax at source in France.

#### Closed-ended retail funds

**Funds.** In relation to an *OPCVM à formule*, the rules are similar to those that apply to open-ended retail funds (see above, *Open-ended retail funds: Funds*). As a joint ownership structure without a legal personality, closed-ended private equity funds (FCPR, FCPI and FIP) are not liable to CIT.

Under certain conditions, SICAFs benefit, during the first three years following their formation, from a CIT exemption on capital gains and income derived from their portfolio's assets. After this three-year period:

- Listed SICAFs continue to benefit from the full exemption on income and capital gains.
- Non-listed SICAFs only benefit from a CIT exemption for capital gains.

**Resident investors.** Distributions received by individual investors from a SICAF are treated as dividends, and are therefore subject to income tax at the progressive tax rates up to 41%, after the application of a 40% rebate and an additional allowance of EUR1,525 or EUR3,050 (depending on their marital status). Individual investors may opt to subject those distributions to a final withholding tax of 19%, without any rebate or allowance (the rate of the withholding tax is expected to be raised to 24%, effective on 1 January 2012). In both cases, social levies apply at the rate of 13.5%.

Individual investors investing in a closed-ended private equity fund (FCPR, FCPI or FIP) benefit, under certain conditions, from an income tax exemption on distributions and capital gains

derived from their investment (except social levies of 13.5%). In addition, under certain conditions, individual investors investing in an FCPI or a FIP are entitled to a tax credit equal to 22% of the subscription price. This tax credit cannot exceed EUR5,280 for a married couple and EUR2,640 for a single person. The 2012 finance law currently under discussion plans to reduce the tax credit proportion to 18.7%, which would lead to a cap of EUR4,488 for a married couple and EUR2,244 for a single person.

The French tax authorities have not indicated if the mark-to-market rule applies to corporate investors in a SICAF. A tax relief is available for corporate investors in an FCPI or a FIP, although these funds are generally designed for retail investors.

**Non-resident investors.** Similar rules apply as for open-ended retail funds (see above, *Open-ended retail funds: Non-resident investors*).

#### Reform

#### 14. What proposals (if any) are there for the reform of retail fund legislation?

The transposition into French law of the UCITS IV Directive has been a catalyst for important discussions and exchanges between the industry and the AMF which have not been limited to the scope of the UCITS IV Directive. This has led to a modernisation of the French regulatory framework applicable to investment management on a broader level, notably in order to strengthen the competitiveness of the French asset management industry. The transposition of the UCITS IV Directive has introduced a number of significant amendments including a revised simplified UCITS passport regime, a management company passport regime and the possibility of creating cross-border "master feeder" structures.

There are also discussions about the competitiveness of the French market in relation to asset management activities.

In recent years, there have been several litigation cases concerning the liabilities of the custodian of a fund who transferred the fund's assets to a sub-custodian. The question was whether the custodian was responsible or not for returning the assets of the fund he had entrusted to a sub-custodian. In May 2010, the highest civil court (*Cour de Cassation*) confirmed the liability of the custodian and the obligation to pay restitution to investors, even though the assets had been entrusted to a sub-custodian.

#### HEDGE FUNDS

#### 15. What is the structure of the hedge funds market? What have been the main trends over the last year?

The existing alternative asset management vehicles were introduced into French law in 2003. The French hedge fund market is therefore still relatively new. It is, however, a growing niche market but has been hit by the global financial crisis.

The French parliament and regulator tend to be more flexible on the rules relating to the strategies and setting-up of hedge funds. One example is contractual funds which are certainly the most flexible type of funds, notably since an order passed in 2008 which authorises these investment funds to invest in any type of assets, which do not need to be financial instruments, provided they comply with some requirements. These investment funds constitute a real alternative to Luxembourg or Irish investment funds. The assets under management were, on 31 December 2010, EUR13.7 billion (for French funds of alternative funds), representing a decrease of 7% since 2009.

### Regulatory framework and bodies

#### 16. What are the key statutes and regulations that govern hedge funds in your jurisdiction? What regulatory bodies are involved in regulating hedge funds?

##### Regulatory framework

The term hedge fund is not strictly defined in French regulations. However, three types of alternative management funds existing under French law may qualify, to a certain extent, as hedge funds. These include:

- Funds of hedge funds (*OPCVM de fonds alternatifs*).
- Funds with relaxed investment rules which can be used as funds of hedge funds (*OPCVM agréés à règles d'investissement allégées* (OPCVM ARIAs)).
- Contractual funds (*OPCVM contractuels*).

Funds implementing hedge investment strategies generally have the following characteristics:

- They may invest more than 10% of their assets in other hedge funds.
- There are fewer investment restrictions compared to other funds.
- Retail investors are not generally allowed to invest in them.

##### Regulatory bodies

Except for contractual funds, which are only filed to the AMF, hedge funds must be authorised by the AMF.

All these funds are regulated by the same body of rules applicable to retail funds (see *Question 2*) and further specific requirements (see *below*).

#### 17. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

##### Risk

French regulations do not specifically regulate investment strategies implemented by hedge funds. Risk is therefore controlled through the ratios applicable to the funds and the type of financial instruments that they can purchase, for example:

- Funds of hedge funds invest more than 10% of their assets in other hedge funds and are subject to the 5/10/40 diversification rules.

- OPCVM ARIA are subject to more relaxed investment ratios and can be used as funds of hedge funds with only a 20% ratio by underlying funds.
- OPCVM ARIA are exempt from the requirements on risk spreading and concentration ratios, and can leverage up to four times their assets. They have no counterparty risk constraints.
- Contractual funds are not licensed by the AMF and their investment policy and investment restrictions are freely determined in their prospectus.

The SGPs managing these funds must be licensed by the AMF with a specific programme of activity relating to the use of specific financial instruments (for example, complex derivatives and credit derivatives). There must also be a risk controller within the management company.

##### Valuation and pricing

The hedge fund's SGP must publish the net asset value and communicate it to any person upon request. During its review of an SGP's licence, the AMF must ascertain that the SGP has the necessary technical means to value assets under management. The frequency with which net asset value is calculated and published depends on the type of fund. The net asset value must be calculated on a monthly basis for leverage funds (including funds of hedge funds), funds with relaxed investment rules, and funds with relaxed investment rules and leverage effect. The net asset value of contractual funds must be calculated four times per year.

##### Systems and controls

The following controls are in place:

- **Internal control.** The SGP must have a suitable internal structure in place to supervise and monitor its activities, and ensure compliance with ethical rules. In particular, it must:
  - oversee its own activities, its managers and employees, individuals acting on its behalf, and any intermediaries and depositaries;
  - implement a system for supervising internal operations and procedures.

To implement this control, the SGP must appoint a compliance and internal control officer, who is in charge of compliance and continuous and periodic monitoring (*Article 313-63, General Regulations*).

- **Depository.** The fund's depository controls the SGP's decisions and must ensure that the hedge fund complies with the law, and its articles of association or internal regulations (*Articles L. 214-16 and L. 214-26, Code and Article 323-1, General Regulations*).
- **Audit.** The auditor (*commissaire aux comptes*) constitutes another level of control of the hedge fund.

The periodic reporting requirements to investors and regulators are the same as for retail funds (see *Question 12*).





### Insider dealing and market abuse

Hedge funds are subject to the standard rules relating to insider dealing and market abuse, breach of which can result in criminal prosecution and/or administrative proceedings before the AMF.

### Transparency

Hedge funds must report to investors and regulators in the same manner as retail funds (see *Question 12*).

### Money laundering

SGPs managing hedge funds are subject to the standard money laundering and terrorist financing regulations (*Articles 313-49 et seq, General Regulations*). For example, the management company must:

- Obtain and verify the identity of any investor before entering into an agreement with them.
- Examine any unusual or complex transaction that appears to have no economic justification.
- Report suspicious amounts and transactions.
- Maintain written records of its monitoring activity.

These requirements can be adapted to suit the SGP's marketing, particularly where the SGP has no direct relationship with the investors.

### Short selling

French regulations provide for transparency requirements in relation to net short positions giving rise to an exposure to the issued share capital of companies admitted to trading on a regulated market or an "organised" multilateral trading facility (MTF) (*Article 223-37, General Regulations*).

This disclosure obligation applies to net short positions related to shares admitted to trading on a French regulated market (for example, NYSE Euronext Paris) or a French organised MTF (for example, Alternext Paris) and for which that market is the reference market.

In addition, the AMF is entitled to take extraordinary measures in the event of exceptional circumstances which threaten the stability of financial markets. These measures may concern restrictions on the conditions of negotiation of securities, in particular the prohibition of short selling regarding certain securities (*Article L.421-16-II, Code*).

### Marketing

#### 18. Who can market hedge funds?

Similar rules apply as for retail funds (see *Question 4*).

#### 19. To whom can hedge funds be marketed?

### OPCVM ARIA

Eligibility for investing in an OPCVM ARIA is determined by the proposed level of investment as follows (*Article L. 214-33, Code and Article 412-45, General Regulations*):

- **EUR125,000 and above.** Open to all investors.
- **EUR10,000 to below EUR125,000.** Open to:

- investors who hold EUR1 million or more in deposits, life insurance products or financial instruments;
- investors who have held a professional position in the financial sector for at least one year that has enabled them to acquire knowledge about the strategy implemented by the fund.

- **Below EUR10,000.** Open to:

- French or foreign qualified investors (see below, *Qualified investors*);
- a state, or in relation to federal states, the members of the federation;
- the European Central Bank and other central banks, the World Bank, the International Monetary Fund and the European Investment Bank;
- companies meeting at least two of the three following criteria:
  - a total balance sheet of EUR20 million;
  - a turnover EUR40 million;
  - a capital of EUR2 million.

### Contractual fund

Eligibility for investing in a contractual fund is determined by the proposed level of investment as follows (*Article 412-76, General Regulations*):

- **EUR250,000 and above.** Open to all investors.

- **EUR30,000 to below EUR250,000.** Open to:

- investors who hold EUR1 million or more in deposits, life insurance products or financial instruments;
- investors who have held a professional position in the financial sector for at least one year that has enabled them to acquire knowledge about the strategy implemented by the fund.

- **Below EUR30,000.** Open to:

- French or foreign qualified investors (see below, *Qualified investors*);
- a state, or in relation to federal states, the members of the federation;
- the European Central Bank and other central banks, the World Bank, the International Monetary Fund and the European Investment Bank;
- companies meeting at least two of the three following criteria:
  - a total balance sheet of EUR20 million;
  - a turnover EUR40 million;
  - a capital of EUR2 million.

### Funds of hedge funds

Eligibility for investing in funds of hedge funds is determined by the proposed level of investment as follows (*Article 412-56, General Regulations*):

- **EUR10,000 and above.** All investors, where the fund of hedge funds is not a capital guaranteed fund.
- **Below EUR10,000.** Open to:

- all investors, where the fund of alternative funds is a capital guaranteed fund;
- French or foreign qualified investors (*see below, Qualified investors*);
- a state, or in relation to federal states, the members of the federation;
- the European Central Bank and other central banks, the World Bank, the International Monetary Fund and the European Investment Bank;
- companies meeting at least two of the three following criteria:
  - a total balance sheet of EUR20 million;
  - a turnover of EUR40 million;
  - capital of EUR2 million.

#### Qualified investors

Qualified investors are listed in Article D. 411-1 of the Code. This list comprises two groups. The first group are automatically considered as qualified investors without needing to be registered, and include notably:

- Credit institutions.
- Investment firms.
- Insurance and capitalisation companies.
- Venture capital companies.
- Organisation for economic co-operation and development (OECD) member states.
- The European Central Bank.
- Companies, which according to their last annual or consolidated accounts, meet at least two of the following three criteria:
  - an average number of employees during the financial year of more than 250;
  - a total balance sheet exceeding EUR43 million;
  - an annual net turnover exceeding EUR50 million.

The second group includes entities and individuals that must be registered with the AMF to be qualified investors and includes:

- Companies, which according to their last annual or consolidated accounts, meet at least two of the following three criteria:
  - an average number of employees during the financial year of more than 250;
  - a total balance sheet exceeding EUR43 million;
  - an annual net turnover exceeding EUR50 million.
- Individuals who meet at least two of the following criteria:
  - the size of the investor's securities portfolio exceeds EUR500,000;
  - the investor has carried out transactions for more than EUR600 per transaction, at an average frequency of at least ten per quarter over the previous four quarters;

- the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment.

Foreign hedge funds cannot be marketed in France as only funds authorised by the AMF are allowed to be distributed on French territory.

#### Investment restrictions

##### 20. Are there any restrictions on local investors investing in a hedge fund?

Local investors can invest in French hedge funds provided they meet the conditions laid down by French regulations (*see Question 19*).

#### Assets portfolio

##### 21. Who holds the portfolio of assets? What regulations are in place for its protection?

Similar rules apply as for retail funds (*see Question 7*).

In relation to prime brokers, the use of prime brokerage is regulated. A conformity letter, signed by the prime broker and the SGP, summarising the terms and conditions under which the prime broker may conduct its activity, must be sent to the AMF at the time of the fund's registration.

#### Requirements

##### 22. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

Hedge funds must produce a prospectus and submit it to the AMF. The characteristics and the risks linked to the investment must be disclosed and explained. A specific warning about the inherent risks must be included.

For contractual funds, the content of the prospectus is not approved in advance by the AMF but only filed with the regulator.

##### 23. What are the key requirements that apply to managers or operators of hedge funds?

Managers of retail funds and hedge funds are subject to the same licensing, supervision and organisation requirements as for retail funds (*see Question 6*).

In addition, managers of the following categories of hedge funds must submit a specific programme of activity to the AMF:

- Funds of hedge funds.
- Funds with relaxed investment rules and leverage effect.
- Contractual funds.



### Legal fund vehicles and structures

24. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

#### Legal vehicles

Hedge funds use the same legal vehicles as are used for retail funds (see *Question 8*).

**Advantages.** These are the same as for retail funds (see *Question 8*).

**Disadvantages.** These are the same as for retail funds (see *Question 8*).

25. What are the advantages and disadvantages of using onshore and offshore structures?

#### Onshore

**Advantages.** French regulations offer a wide range of vehicles that can be freely marketed in France.

**Disadvantages.** There can be certain tax disadvantages to using onshore structures.

#### Offshore

**Advantages.** Closed-ended funds can be marketed on the private placement basis. However, it should be noted that the AMF considers that private placement is not applicable in relation to open-ended collective investment schemes and in particular non-authorised offshore funds, as all funds must be authorised for marketing by the AMF in order to be marketed in France.

**Disadvantages.** The marketing of offshore funds requires the prior authorisation of the AMF, since those funds do not benefit from the European passport provided for in the UCITS Directive (*Article L. 214-2, Code*). The AMF has adopted a broad definition of the marketing of foreign funds, which may encompass advertising, solicitation or all active placements by investment services providers. This authorisation is, in practice, almost impossible to obtain.

### Tax treatment

26. What is the tax treatment for hedge funds?

#### Funds

Hedge funds are taxed in the same way as retail funds (see *Question 13*).

#### Resident investors

Hedge funds are taxed in the same way as retail funds (see *Question 13*).

#### Non-resident investors

Hedge funds are taxed in the same way as retail funds (see *Question 13*).

### Restrictions

27. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

#### Redemption of interest

In principle, shares or units are redeemable on request, although the restrictions that apply to retail funds also apply to hedge funds (see *Question 10*). However, the articles of association or internal regulations of a contractual fund may only allow redemptions in the first two years of the fund (*Article L. 214-35-5, Code*).

#### Transfer to third parties

Transfers of shares or units of a hedge fund are only subject to the transferor being an eligible investor to the relevant vehicle (see *Question 19*). Additionally, transfers to third parties may be subject to the SGP's prior approval, if the prospectus so provides.

### Reform

28. What (if any) proposals are there for the reform of hedge fund regulation?

The major reform currently being discussed is the Alternative Investment Fund Managers Directive, which will affect the regulation of French hedge funds.

CONTRIBUTOR DETAILS



**STÉPHANE PUEL**

*Gide Loyrette Nouel*

**T** +33 1 40 75 29 69

**F** +33 1 40 75 37 02

**E** [puel@gide.com](mailto:puel@gide.com)

**W** [www.gide.com](http://www.gide.com)

**ARNAUD PINCE**

*Gide Loyrette Nouel*

**T** +33 1 40 75 22 48

**F** +33 1 40 75 37 02

**E** [pince@gide.com](mailto:pince@gide.com)

**W** [www.gide.com](http://www.gide.com)

**Qualified.** *Avocat à la Cour*: Paris, 1998

**Areas of practice.** Investment funds.

**Recent transactions**

- Structuring various types of fund, advising funds to adapt fund structures to the latest market practices in light of local regulatory and tax constraints, and negotiating with potential investors and counterparties.
- Creating and documenting, including preparing the fund's prospectus and PPM, and setting up offshore and onshore funds and investment management vehicles.

**Qualified.** Admitted to the Paris Bar

**Areas of practice.** Investment funds.

**Recent transactions**

- Structuring various types of fund, advising funds to adapt fund structures to the latest market practices in light of local regulatory and tax constraints, and negotiating with potential investors and counterparties.
- Creating and documenting, including preparing the fund's prospectus and PPM, and setting up offshore and onshore funds and investment management vehicles.



# A Complete Funds Legal Practice

**Gide Loyrette Nouel is a premier international law firm operating from 19 offices in 15 countries with 650 lawyers.**

Led by an integrated platform of English, French, Hong Kong and US lawyers, Gide Loyrette Nouel's Investment Funds Group conducts complex cross-border transactions related to all aspects of funds' activities. It combines the unique expertise of both common law and civil law lawyers.

Through a global network of 19 offices in Europe, Asia, North America and Africa, no matter where a fund makes its investments or offers its securities, the firm can provide comprehensive and local legal advice on the following matters:

- Fund structuring & documentation
- Taxation
- Financial services regulations
- Capital markets
- Structured finance & derivatives
- Regulatory investigations

Our lawyers have advised on and structured numerous types of funds, focusing on:

- Hedge funds
- Private equity funds (including infrastructure funds)
- UCITS funds
- Real estate funds
- Structured funds
- Funds of funds (including secondary funds)
- CDOs of hedge funds and private equity funds

**Best European Law Firm of the Year**  
ILASA 2010

**France Law Firm of the Year**

Chambers Europe Awards 2008, 2010 & 2011  
I.F.L.R. Awards 2005, 2006 & 2010  
PLC Which Lawyer? Awards 2010

Who's Who Legal Awards 2006, 2007, 2010 & 2011  
ILASA 2009 & 2011  
The Lawyer European Awards 2009

## Contacts

### Paris

Tel. +33 (0)1 40 75 29 69

**Stéphane Puel**

puel@gide.com

### London

Tel. +44 (0)20 7382 5500

**Lucy Frew**

lfrew@gide.com

### New York

Tel. +1 212 403 67 00

**Robert MacDonald**

macdonald@gide.com

### Hong Kong

Tel. +852 2536 9110

**Balbir Bindra**

bindra@gide.com

### Ho Chi Minh City

Tel. +84 8 3823 8599

**Samantha Campbell**

samantha.campbell@gide.com

For more information:

**www.gide.com**



**Gide Loyrette Nouel**

Algiers ■ Beijing ■ Brussels ■ Bucharest ■ Budapest ■ Casablanca ■ Hanoi ■ Ho Chi Minh City  
Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Moscow ■ New York ■ Paris ■ Saint Petersburg ■ Shanghai ■ Tunis ■ Warsaw