

France

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RETAIL FUNDS

1. Please give a brief overview of the retail funds market in your jurisdiction. (How developed is the market? Has it been active in the past year?)

Open-ended retail funds

Until December 2007, the French investment fund industry had double-digit growth. French investment managers managed at the end of 2007 about EUR1,470 billion (about US\$2,037 billion) of the EUR7,909 billion (about US\$10,957 billion) invested in European funds, representing one-fifth of the European fund management industry. After an important decrease in 2008 (about EUR233 billion (about US\$323 billion)), the amount of French assets under management considerably increased in 2009 and represented at the end of 2009 EUR1,380 billion (about US\$1,912 billion) (remaining at around one-fifth of the European fund management industry) (*Sources: European Fund and Asset Management Association, Autorité des Marchés Financiers (AMF) and Association Française de la Gestion Financière (AFG)*).

Asset management companies are divided into two categories: subsidiaries of banking groups and entrepreneurial companies. At the end of 2008, two French groups were among the ten biggest world asset management groups and four French groups were among the 20 biggest world asset management groups. In ten years, the number of French management companies almost doubled, to 591 management companies at the end of 2009 (*Source: AMF*).

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 revamped by an Order dated 30 January 2009 (Order 2009-107). The SICAFs are now listed in the Financial and Monetary Code as undertakings for collective investment. However, this reform was implemented in France in the middle of the 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 several years.

In addition to the SICAFs, some funds, such as the *fonds commun de placement dans l'innovation* (FCPI) (a tax incentive form of private equity fund) and the guaranteed or structured fund (*OPCVM à formule*) (a fund where the portfolio's performance depends on a pre-defined calculation, based on market predictions, with a guar-

anteed return), although formally open, are meant to be held to maturity. These last two have achieved a share of the market.

2. What are the key statutes, regulations and rules that govern retail funds in your jurisdiction? What regulatory bodies are involved in regulating retail funds?

Open-ended retail funds

The main provisions governing 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, regular French civil and commercial rules also apply to retail funds.

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 are, among other things, to:

- Safeguard investments in financial instruments and in all other savings and investment vehicles.
- Ensure that investors receive correct and precise information.
- Maintain orderly financial markets.

In the performance of its duties, the AMF is entitled, among other things, to:

- 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

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

3. Do the retail funds themselves have to be authorised or licensed? If so, what are the main steps involved?

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 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.

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.

4. Who can market retail funds?

Open-ended retail funds

The marketing of funds was traditionally an unregulated activity in France. Only solicitation activities were 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 became a regulated activity amalgamated with investment service advice and reception and transmission of orders (when not performed by the management companies of the funds). This makes it restricted to investment services providers.

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

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 minimum amount). In particular, the 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 411-12, General Regulations*).

Closed-ended retail funds

A SICAF cannot offer securities to the public unless the amount of each share of the SICAF is higher than the amount fixed in a decree (*Article L. 214-151, 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 the amount provided for in the decree, 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.

6. What are the key requirements that apply to managers/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 (about US\$173,220);
 - 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 who 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 of 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.

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*).

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 depositary (*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 depositary 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 depositary must be duly authorised in France by the *comité des établissements de crédit et des entreprises d'investissements* (one of the principal financial services regulators in France) and it is prohibited for the same company to act both as depositary 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 (*service de conservation d'instruments financiers pour compte de tiers*) (*Article L. 214-150, Code*). The name of the custodian must be indicated in the articles of incorporation of the SICAF.

Such 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 are the same as the ones exercised by a depositary of an OPCVM (*Article L. 214-150, Code*).

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? What are the participants' interests in the fund called (for example, share or unit)?

Open-ended retail funds

OPCVMs may adopt two different legal forms:

- **Société d'investissement à capital variable (SICAV).** These are open-ended companies governed 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 with regard to third parties, and a depositary.

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

Closed-ended retail funds

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.

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.

9. Describe the investment and borrowing restrictions to which retail funds are subject.

Open-ended retail funds

Retail funds are generally subject to:

- Diversification ratios (5/10/40).
- 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. 214-174, 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/operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

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

In addition, funds can stop issuing units when either (*Article L. 214-30, Code and Article 411-12 2°, General Regulations*):

- The OPCVM is dedicated to a maximum of 20 unitholders or to a certain category of investor mentioned in the fund's regulations.
- The FCP's regulations define objective situations that trigger a temporary or definitive closure of subscriptions, such as a maximum number of units to be issued, a maximum amount of assets or the term of an allotted subscription period.

Redemption. For both SICAVs (*Article L. 214-15, Code*) and FCPs (*Article L. 214-20, Code*), shares or units may 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:

- There are exceptional circumstances.
- It is required for the unitholder's or shareholder's best interests.

The SGP must notify the AMF of the reasons and procedures for suspending redemptions (*Article 411-13, General Regulations*).

In addition, the redemption of units is suspended when either:

- The assets of a SICAV fall below EUR4 million (about US\$5.5 million).
- The assets of an FCP fall below EUR300,000 (about US\$415,730).

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 will be able to 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 FCPs and structured funds. A lock-in period of ten years may also be imposed on unitholders in FCPs.

11. Describe 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 respect of shares or units of funds, except as to index funds (trackers).

Closed-ended retail funds

Non-listed SICAFs may impose restrictions on transfers such as approval clauses or pre-emption rights. Listed SICAFs cannot impose restrictions.

12. Describe the periodic reporting requirements to:

- Investors.
 - Regulators.
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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 depositary'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.

13. Describe the tax treatment for:

- **Funds.**
- **Resident investors.**
- **Non-resident investors.**

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 the 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 normally 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 30.1% (including social levies) when total sales of transferable securities made during the calendar year by the fiscal household exceed EUR25,830 (about US\$35,790).

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 33.3%. An additional social contribution of 3.3% is due by certain companies whose CIT exceeds EUR763,000 (about US\$1.06 million), 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 states which are members of the EC.

- **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 18% to 25% for French source dividend income, and 50% on French source income paid in non-co-operative jurisdictions).

Income distributed by a SICAV is considered as French source dividends for French tax purposes and is therefore subject to a 25% withholding tax in France (or 18% if paid to individual investors residing in the EC, Norway or Iceland), subject to tax treaties. However, domestic withholding tax is increased to 50% if dividends are paid in a non-co-operative jurisdiction.

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*). FCPIs are not liable to CIT. Listed SICAFs benefit from an exemption of CIT if they have a minimum share capital of EUR3 million (about US\$4.16 million).
- **Resident investors.** Generally, the tax regime applicable to individual investors in a SICAF is the same as the tax regime applicable in the case of an investment in a SICAV (see above, *Open-ended retail funds: Resident investors*). Individual investors investing in an FCPI benefit, under certain conditions, from an income tax exemption on distributions and capital gains derived from their investment. In addition, under certain conditions, when investing in an FCPI, individual investors are entitled to a tax credit of 25% of the subscription price (up to a maximum of EUR40,000 (about US\$55,430) (EUR100,000 (about US\$138,580) for subscriptions in certain small companies created less than five years previously)) of their units; that is, a EUR10,000 (about US\$13,860) maximum tax credit for a married couple (EUR25,000 (about US\$34,460) if the investment is realised in certain small companies created less than five years previously).

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, although FCPIs 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*).

14. Please summarise any proposals for the reform of retail fund regulation in your jurisdiction.

The main proposal for reform currently being examined is the implementation of Directive 2009/65/EC (UCITS IV), which will introduce a number of significant amendments including a revised streamlined UCITS passport regime.

HEDGE FUNDS

15. Please give a brief overview of the hedge funds market in your jurisdiction. (How developed is the market? Has it been active in the past year?)

As most of the existing alternative asset management vehicles were introduced into French law in 2003, the French hedge fund market is still young. It is a growing niche market but was hit by the financial crisis. In December 2007, the assets under management in France represented about US\$52 billion of US\$186.4 billion (about EUR258 billion) worldwide. In April 2009, the assets under management only represented US\$23 billion (about EUR32 billion) of US\$1,000 billion (about EUR1,385 billion) worldwide (*Source: AMF*).

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

The term hedge fund is not strictly defined in French regulations. However, five 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 lightened investment rules and without leverage effect, which can be used as funds of hedge funds (*OPCVM agréés à règles d'investissement allégées sans effet de levier*) (OPCVM ARIA SEL).
- Funds with lightened investment rules and leverage effect (*OPCVM agréés à règles d'investissement allégées à effet de levier*) (OPCVM ARIA EL).
- Contractual funds (*OPCVM contractuels*).
- Futures funds (*fonds communs d'intervention sur les marchés à terme*) (FCIMT). These are funds investing the majority of their assets in listed derivatives products (futures and options).

In general, funds implementing hedge investment strategies have the following characteristics:

- They may invest more than 10% of their assets in other hedge funds.
- There are less investment restrictions compared to other funds.

- Retail investors are not generally allowed to invest in them.

Except for contractual funds, hedge funds must be authorised by the AMF.

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

17. How are the following areas regulated (if at all) in relation to hedge funds:

- **Risk.**
- **Valuation and pricing.**
- **Systems and controls.**
- **Insider dealing and market abuse.**
- **Transparency.**
- **Money laundering.**
- **Short selling.**

- **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 may 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;
- ARIA SEL are subject to more relaxed investment ratios and may be used as funds of hedge funds with only a 20% ratio by underlying funds;
- ARIA EL are exempt from the requirements on risk spreading and concentration ratios, and may 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;
- futures funds invest the majority of their assets in listed derivatives products (futures and options).

The SGPs managing such 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).

- **Valuation and pricing.** The investment management company must publish the net asset value and communicate it to any person on 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.

In order to implement such 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*).

- **Depositary.** The fund's depositary 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 may be adapted to suit the SGP's marketing, especially where the SGP has no direct relationship with the investors.
- **Short selling.** In September 2008, further to the positions taken by other regulators, the AMF instituted rules relating to short selling. The main rules are as follows:
 - the prohibition of unsecured transactions (that is, investors must hold in their portfolios 100% of the securities to be sold before the order is executed);
 - obligations for investment firms to ascertain that their clients have appropriate coverage;
 - obligations to notify a net economic position exceeding 0.25% of the share capital of the issuers concerned;
 - prohibition to lend the securities concerned;

- investment managers are required to aggregate all the sell positions held on behalf of the funds or accounts they manage. The position must be aggregated at the group level.

The AMF confirmed on 27 January 2010 that these rules are still applicable until further notice.

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 (SEL or EL)

Eligibility for investing in an OPCVM ARIA (SEL or EL) is determined by the proposed level of investment as follows (*Article L. 214-35-1, Code and Article 413-2, General Regulations*):

- **EUR125,000 (about US\$173,220) and above.** Open to all investors.
- **EUR10,000 (about US\$13,860) to below EUR125,000.** Open to:
 - investors who hold EUR1 million (about US\$1.4 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 (about US\$27.7 million);
 - a turnover EUR40 million (about US\$55.4 million);
 - a capital of EUR2 million (about US\$2.8 million).

Contractual fund

Eligibility for investing in a contractual fund is determined by the proposed level of investment as follows (*Article 413-35, General Regulations*):

- **EUR250,000 (about US\$346,440) and above.** Open to all investors.
- **EUR30,000 (about US\$41,570) to below EUR250,000.** Open to:

- investors who hold EUR1 million (about US\$1.4 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.

FCIMTs

Eligibility for investing in FCIMTs is determined by the proposed level of investment as follows (*Article 416-2, General Regulation*):

- **EUR10,000 and above.** All investors.
- **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.

Funds of hedge funds

Eligibility for investing in funds of hedge funds is determined by the proposed level of investment as follows (*Article 413-13, 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;

Qualified investors

Qualified investors are listed in Article D. 411-1 of the Code. This list is composed of 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 (about US\$59.6 million);
 - an annual net turnover exceeding EUR50 million (about US\$69 million).

The second group includes entities and individuals that have to be registered with the AMF in order 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 (about US\$692,885);
 - the investor has carried out transactions for more than EUR600 (about US\$830) 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.

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

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

Regarding 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.

21. Describe the key disclosure or filing requirements (if any) that must be done by the fund (for example, in relation to the prospectus or offering memorandum and side letters).

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.

22. What are the key requirements that apply to managers/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.

23. 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? What are the participants' interests in the fund called (for example, share or unit)?

Hedge funds use the same legal vehicles, with the same advantages and disadvantages, as are used for retail funds (see Question 8).

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

Onshore

French regulation offers a wide range of vehicles that can be freely marketed in France.

Offshore

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. 214-1 II, 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.

In addition, the AMF considers that private placement is not applicable with respect to collective investment schemes and in particular non-authorised offshore funds (only closed-ended funds could be marketed on the private placement basis).

25. Describe the tax treatment for:

- Funds.
- Resident investors.
- Non-resident investors.

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

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

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*).

27. Please summarise any proposals for the reform of hedge fund regulation in your jurisdiction.

The major reform currently being discussed is the Alternative Investment Fund Managers Directive, which is still subject to negotiation, and will have an impact on the regulations of French hedge funds.

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