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# THE PRIVATE EQUITY REVIEW

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SECOND EDITION

EDITOR  
KIRK AUGUST RADKE

LAW BUSINESS RESEARCH

# THE PRIVATE EQUITY REVIEW

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For further information please email  
[Adam.Sargent@lbresearch.com](mailto:Adam.Sargent@lbresearch.com)

# THE PRIVATE EQUITY REVIEW

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Second Edition

Editor  
KIRK AUGUST RADKE

LAW BUSINESS RESEARCH LTD

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# EDITOR'S PREFACE

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This second edition of *The Private Equity Review* contains the views and observations of leading private equity practitioners in 24 jurisdictions, spanning every region of the world. This worldwide survey reflects private equity's emerging status as a global industry. Private equity is not limited to the United States and western Europe; rather, it is a significant part of the financial landscape in developed countries and emerging markets alike. Today, there are more than a dozen private equity houses that have offices around the world, with investment mandates matching such global capabilities. In addition to these global players, each region has numerous indigenous private equity sponsors.

As these sponsors seek investment opportunities in every region of the world, they are turning to practitioners in each of these regions and asking two key commercial questions: 'how do I get my private equity deals done here?', and the corollary question, 'how do I raise private equity money here?'. This review provides many of the answers to these questions.

Another recent global development that this review addresses is the different regulatory schemes facing the private equity industry. Policymakers around the world have recognised the importance of private equity in today's financial marketplace. Such recognition, however, has not led to a universal approach to regulating the industry; rather, policymakers have adopted many different schemes for the industry. The following chapters help provide a description of these various regulatory regimes.

It remains to be seen how 2013 will treat private equity sponsors, and whether the world will see uniform opportunities for deals and fundraising in all regions, or rather a series of disjointed stories, with opportunities in some regions and none in others.

I wish to thank all of the contributors for their support of this second volume of *The Private Equity Review*. I appreciate that they have taken time from their practices to prepare these insightful and informative chapters.

**Kirk August Radke**  
Kirkland & Ellis LLP  
New York  
March 2013

## Chapter 3

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# FRANCE

*Stéphane Puel and Julien Vandenbussche*<sup>1</sup>

### I GENERAL OVERVIEW

The amount of private equity fundraisings increased by 22 per cent during the first half of 2012 compared with the first half of 2011, to €1.79 billion.<sup>2</sup> However, such amount only represents 28 per cent of the global fundraisings in 2011, and the global amount of fundraisings for 2012 is expected to be historically low.

The number of private equity funds in fundraising also increased by 68 per cent during the first half of 2012 compared with the first half of 2011 (99 vehicles for the first half of 2012 and 59 vehicles for the first half of 2011), which is in line with the number of vehicles for the first half of 2010.

The French market is led in particular by six fundraisings amounting to over €100 million each (€865 million in total). Half of the private equity fundraisings in 2012 were made by small-cap funds (less than €20 million) and mid-cap funds (between €20 million and €100 million). A large number of vehicles (79 over 99) raised amounts smaller than or equal to €20 million.

Venture capital funds ('FCPRs') remain the favourite vehicles for fundraising, having collected €1.492 billion, far above the amounts collected by innovation funds ('FCPIs') and local investment funds ('FIPs') (respectively €72 million and €145 million).

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1 Stéphane Puel is managing partner and Julien Vandenbussche is a senior associate at Gide Loyrette Nouel AARPI.

2 'Activity of French private equity', a study regarding the first half of 2012, Grant Thornton and Association Française des Investisseurs en Capital.

## II LEGAL FRAMEWORK FOR FUNDRAISING

Until the transposition of the Alternative Investment Funds Managers Directive ('the AIFM Directive')<sup>3</sup> into French law, expected in July 2013, French management companies are required to solely manage French funds.

### i Common legal forms for funds

#### *Venture capital funds*

French regulations provide for five different types of venture capital funds:

- a* FCPRs – assets of such funds account for at least 50 per cent of participating securities or securities of unlisted companies;<sup>4</sup>
- b* FCPIs – assets of such funds account for at least 60 per cent of securities issued by innovative companies;<sup>5</sup>
- c* FIPs – assets of such funds account for at least 60 per cent of securities issued by small and mid-cap companies whose activities are located in a restricted geographical area;<sup>6</sup>
- d* contractual venture capital funds benefit from relaxed investment restrictions (i.e., are not required to comply with the aforementioned FCPR quota), are not licensed by the French Financial Markets Authority ('the AMF'), but are restricted to certain investors;<sup>7</sup> and
- e* simplified procedure venture capital funds benefit from relaxed investment restrictions, are not licensed by the AMF, but are restricted to certain investors.<sup>8</sup>

Interests held by investors in the aforementioned venture capital funds are called units.

Contractual venture capital funds and simplified procedure venture capital funds are now entitled to create different categories of shares giving different rights on part or all of the fund's assets.

#### *Closed-ended funds*

Closed-ended investment companies with fixed capital ('SICAF') can only take the legal form of a limited liability company.<sup>9</sup> Therefore, the provisions concerning limited liability companies in the French Commercial Code apply, with some exceptions. The SICAF legal regime was extensively modified in 2009.<sup>10</sup>

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3 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, and amending Directives 2003/41/EC and 2009/65/EC, and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010.

4 Article L214-28 of the French Monetary and Financial Code ('the MFC').

5 Article L214-30 of the MFC.

6 Article L214-31 of the MFC.

7 Article L214-37 of the MFC.

8 Article L214-38 of the MFC.

9 Article L214-147 of the MFC.

10 Order No. 2009-107 of 30 January 2009.

The most significant difference between limited liability companies and a 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.<sup>11</sup> The only limitation is that when shares are issued at a price that is lower than the net asset value per share, the existing shareholders have a priority right if they wish to subscribe. Further, the minimum initial share capital of a SICAF cannot be less than €8 million.<sup>12</sup>

Interests held by investors in SICAFs are called shares.

## ii Customary or common key legal terms

### *Terms of the fund*

#### *Venture capital funds*

In relation to closed-ended funds, French law provides for a maximum period during which an investor may not request the redemption of its units by the fund. In such cases, it is common practice to align the duration of the fund with the duration of its blocking period.

#### *SICAFs*

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.<sup>13</sup> Subject to these limited exceptions, an investor can only sell shares on a secondary market.

### *Liquidity of interests*

#### *Venture capital funds*

As a matter of principle, the units of a venture capital fund may be redeemed only after the expiry of the blocking period. It is, however, possible to provide in the by-laws of a venture capital fund that units may be redeemed during the blocking period. Outside of these situations, an investor can only sell shares on a secondary market.

#### *SICAFs*

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

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.<sup>14</sup> Subject to these limited exceptions, an investor can only sell shares on a secondary market.

Listed SICAFs can redeem up to 10 per cent of their share capital per year and up to 25 per cent if the price of the shares is 10 per cent less than the net asset value of the shares.<sup>15</sup> An extraordinary general meeting of the SICAF can further authorise the redemption of more than 25 per cent of the shares of the SICAF.

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11 Article L214-152 of the MFC.

12 Article D214-224 of the MFC.

13 Article L214-147 of the MFC.

14 Article L214-147 of the MFC.

15 Article L214-158 of the MFC.



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

### ***Portfolio management companies' involvement***

As far as French venture capital funds are concerned, no specific arrangements are provided regarding the involvement of the portfolio management companies ('SGPs'). In particular, there are no requirements for the SGP to invest seed money in the fund.

Unit holders or shareholders, when investing in a French fund ('OPCVM'), will rely on the regulatory framework applicable to SGPs and French depositaries (for licensing requirements, rules of good conduct, see Section III, *infra*). In this respect, the articles of association or the by-laws of an OPCVM do not authorise the unit holders or shareholders to remove the SGPs.

### ***Remuneration arrangements***

The SGP of a venture capital fund or a SICAF is remunerated by the following fees:

- a* a management commission, whose percentage is mentioned in the prospectus of the OPCVM; and
- b* a share of the subscription and redemption fees, if any, plus ancillary remunerations, in particular performance fees (see below).<sup>16</sup>

The management fee paid to the SGP of an OPCVM may include a variable portion tied to the outperformance of the portfolio relative to the investment objective, subject to specific conditions laid down by French regulations.<sup>17</sup>

In addition to the above, it should be noted that, in a follow-up of recent reflections at international and national level, in particular the decisions of the G20 on the problem of remuneration policy within financial institutions, the AMF has approved common provisions adopted by French asset management associations on remuneration policies within asset management companies.

Furthermore, individuals involved in the management of a French venture capital fund (FCPR, FCPI, FIP, contractual venture capital fund or simplified procedure venture capital fund) may benefit from carried interests represented by units or shares of the venture capital funds to be taxed under the regime applicable to financial capital gains. In order to benefit from this tax regime, the beneficiaries of the carried interest must comply with specific conditions laid down by the French tax administration.

### ***Investment and borrowing restrictions***

#### ***Venture capital funds***

Please refer to Section II.i, *supra*. In addition, FCPR, FCPI, FIP and simplified procedure venture capital fund may make borrowings up to 10 per cent of their respective assets.<sup>18</sup>

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16 Article 314-77 of the General Regulations of the AMF ('the GR AMF').

17 Article 314-78 of the GR AMF.

18 Articles R214-36-1, R214-48-1, R214-66-1 and R214-88-1 of the MFC.

French regulations do not provide for any borrowing possibility as regards contractual venture funds.

#### *SICAFs*

There are no legal or regulatory investment restrictions. The board of directors must determine the investment strategy it intends to pursue.<sup>19</sup>

However, French regulations provide for a principle of risk diversification.<sup>20</sup> A SICAF can invest all or most of its assets in one fund. That target fund must, however, comply with the principle of risk diversification.

### **iii Key disclosure or filing requirements**

#### *Venture capital funds*

Venture capital 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.

A venture capital fund must in particular publish a biannual report of the funds' assets<sup>21</sup> and publish annual accounts at the end of each financial year, including an inventory of the assets and liabilities under management of the venture capital fund.

The requirements relating to the information provided to the investors, such as required language, the form of the key investor information document and the content and periodicity of periodical information, are detailed in the GR AMF.<sup>22</sup>

#### *SICAFs*

A SICAF must publish within eight weeks following the end of each half-year:<sup>23</sup>

- a* the composition of the assets;
- b* the net asset value; and
- c* a report on the fund's exposure to financial risks.

### **iv Solicitation**

#### *Marketing regulations*

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

Following the implementation of the MiFID,<sup>24</sup> 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

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19 Article L214-148 of the MFC.

20 Article L214-147 of the MFC.

21 Article L214-17, applicable to venture capital funds pursuant to Article L214-24-1 of the MFC.

22 Articles 411-106 et seq. of the GR AMF.

23 Article L214-56 of the MFC.

24 Directive 2004/39/EC of the European Parliament and of the Council of 1 November 2007 on markets in financial instruments.

(when not performed by the management companies of the funds or the depositaries). This makes the marketing of funds restricted to investment services providers.

Financial investment advisers are also able to market funds under their existing status, and to receive subscription and redemption orders in relation to shares or units of funds.

### *Venture capital funds*

Any types of investor (individuals or legal entities) can subscribe to units or shares of an FCPR (or an FCPI or FIP) subject to any limitations indicated in the fund's prospectus (such as minimum amount). In particular, subscription to units issued by an FCPR (or an FCPI or FIP) 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.<sup>25</sup>

Subscription and purchase of the units of a simplified procedure venture capital fund<sup>26</sup> or a contractual venture capital fund<sup>27</sup> are restricted to the following persons:

- a* €500,000 – all investors;
- b* €30,000 – investors:
  - who hold €1 million or more in deposits, life insurance products or financial instruments;
  - 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 FCPR; and
  - (both corporate and individual) who have a good knowledge of the private equity sector and unlisted companies, under conditions provided by French regulations; and
- c* no minimum – open generally to qualified investors,<sup>28</sup> states, central banks and large companies.

### *SICAFs*

A SICAF cannot offer securities to the public unless the value of each share of the SICAF is higher than €10,000.<sup>29</sup> The purpose of this rule is to provide for minimum subscription amounts, such as the ones existing for certain OPCVMs.

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25 Article 411-22 of the GR AMF.

26 Article 412-113 of the GR AMF.

27 Article 412-99 of the GR AMF.

28 Qualified investors are listed in Article D411-1 of the MFC. This list comprises two groups. The first group is made up of entities that are automatically considered as qualified investors and that do not need to be registered, in particular credit institutions, investment firms and insurance companies. The second group includes entities and individuals meeting specific conditions, which must be registered with the AMF to be considered as qualified investors.

29 Articles L214-151 and D214-240 of the MFC.

If the price of the share is lower than €10,000, the shares of the SICAF cannot be subject to any financial solicitation, unless the targeted investors fall within the category of qualified investors as defined in Article L411-2.II of the MFC.<sup>30</sup>

### III REGULATORY DEVELOPMENTS

#### i Regulatory framework

French venture capital funds or closed-ended funds must be managed by an SGP duly licensed by the AMF.

The main provisions regulating venture capital funds and closed-ended funds are the following:

- a the French Monetary and Financial Code;
- b the GR AMF, instructions and positions of the AMF, (see below); and
- c conduct of business rules issued by the AFG and the AFIC, the French asset management associations, which represent investment funds and investment management companies.

#### *Regulatory body for venture capital funds and SICAFs*

OPCVMs and SGPs are regulated by the AMF. The AMF is an independent public authority (that has its own financial resources and its own employees) established by the Financial Security Act.<sup>31</sup>

The AMF's duties include:

- a safeguarding investments in financial instruments and in all other savings and investment vehicles;
- b ensuring that investors receive correct and precise information; and
- c maintaining orderly financial markets.

The AMF authorises the setting-up of OPCVMs, during which they verify that the OPCVM complies with all legal and regulatory requirements, and examine the key information set out in its prospectuses.

The AMF subsequently monitors each OPCVM throughout its lifetime, paying particular attention to the information disclosed to investors (such as marketing materials).

#### *Regulatory framework applicable to French SGPs*

##### *Licensing requirements*

A management company must adopt the legal structure of an SGP and be licensed by the AMF in order to manage a French OPCVM.

In this respect, an SGP must be licensed to manage venture capital funds or SICAF. As a result, an application file must be submitted to the AMF, which has, as a matter of principle, a maximum of three months to grant the licence to the SGP.

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30 Article L214-153 of the MFC.

31 Law No. 2003-706 of 1 August 2003.

In order to obtain the AMF licence as a portfolio management company, an SGP must notably fulfil certain conditions,<sup>32</sup> in particular having its registered office in France; having two persons who must be responsible for the effective direction of the SGP's activities; and having a programme of activities specific to the type of financial instruments or securities in which the funds it manages will invest. In this respect, the SGP, in order to manage venture capital funds, must submit a specific programme of activities for investing in non-listed securities to the AMF.

*Ongoing requirements applicable to SGPs*

*Supervision requirements*

The GR AMF 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.

*Organisational rules*

Since the implementation of the MiFID, Book III of the GR AMF sets out organisational rules that each SGP must comply with:

- a* a process for each activity to ensure it complies with the conditions and obligations derived from its licence or its professional duties;
- b* 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; and
- c* reasonable measures to maintain its activity, when outsourcing critical tasks.

Since the transposition of the UCITS IV Directive<sup>33</sup> into French law,<sup>34</sup> the respective obligations of the SGP and of the depositary have been updated in order to reflect the fact that venture capital funds are now created solely upon the initiative of the SGP,<sup>35</sup> instead

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32 Article L532-9 of the MFC.

33 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ('UCITS').

34 Ordinance No. 2011-915 dated 1 August 2011 and its implementing decrees No. 2011-922 and No. 2011-923; Order dated 3 October 2011; AMF Instruction No. 2011-15 dated 3 November 2011 on the OPCVM's overall risk calculation method; AMF Instructions dated 21 December 2011 on the approval procedures, the implementation of KIID and of a prospectus and the periodical information: AMF Instruction No. 2011-19 (coordinated UCITS), AMF Instruction No. 2011-20 (non-coordinated UCITS), AMF Instruction No. 2011-21 (employee savings UCITS), AMF Instruction No. 2011-22 (regulated FCPR, FCPI and FIP), AMF Instruction No. 2011-23 (real estate investment funds) and AMF Instruction No. 2012-01 (risk management).

35 Article L214-8-1 of the MFC.

of being created upon the joint initiative of the SGP and the depositary. Consequently, the depositary has no more responsibility towards the investors in this respect but is liable to the SGP as any service provider.

French regulations now provide for:

- a* a detailed supervisory function of the depositary;
- b* a reference to the fair treatment of the shareholders, replacing the reference to the equal treatment of the shareholders;
- c* a definition of risk management;<sup>36</sup> and
- d* ESG criteria with which the SGP must comply.<sup>37</sup>

## ii Operational requirements

### *Venture capital funds*

#### *Protection of the assets held by venture capital funds*

The venture capital fund's assets must be entrusted with a depositary who has three main functions:

- a* acting as custodian of the assets. The depositary is liable for the safekeeping of the OPCVM's assets and must certify an annual inventory of its assets.<sup>38</sup> As confirmed by recent case law, the depositary remains liable even where it delegates this function to a third party;<sup>39</sup>
- b* ensuring that the SGP's decisions comply with French regulations and the fund's articles of association or regulations; and
- c* executing subscriptions and redemptions of shares or units of the OPCVM, when the depositary is entrusted with the function of centralising subscription and redemption orders.<sup>40</sup>

The depositary must be duly authorised in France by the AMF, and it is prohibited for the same company to act as depositary and SGP.<sup>41</sup>

#### *Regulatory reporting requirements*

SGPs must file an annual information questionnaire relating to the composition of their turnover. The compliance officer may also be required 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.<sup>42</sup>

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36 Article L533-10-1 of the MFC.

37 Article L533-22-1 of the MFC.

38 Article 323-10 of the GR AMF.

39 Article L214-10 of the MFC.

40 Article L214-13 of the MFC.

41 Article L214-9 of the MFC.

42 Article 411-29 of the GR AMF.

*Specific requirements imposed by regulations*

*Risk*

French regulations do not specifically regulate investment strategies implemented by venture capital funds. Risk is therefore controlled through the ratios applicable to the funds and the type of financial instruments that they may purchase (see Section II, *supra*).

For example, the assets of an FCPR may not represent more than 10 per cent of the securities issued by a single issuer and an FCPR may not hold more than 35 per cent of the capital or voting rights of a single issuer.<sup>43</sup>

*Valuation and pricing*

The net asset value must be calculated as a matter of principle twice a month for venture capital funds,<sup>44</sup> but may be calculated on a monthly basis, if such valuation is not detrimental to the interests of the unit holders and subject to the prior approval of the AMF. By way of exception, the net asset value may be calculated twice a year for contractual venture capital funds and simplified procedure venture capital funds.<sup>45</sup>

OPCVM operating rules have become more detailed in terms of amounts available for distribution, composition of the assets and calculation of the overall risk.<sup>46</sup>

*Systems and controls*

The following controls are in place:

- a* internal control – the SGP must have a suitable internal structure in place to supervise and monitor its activities, and ensure compliance with ethical rules;
- b* depositary – the fund's depositary controls the SGP's decisions and must ensure that the venture capital fund complies with the law, and its articles of association or internal regulations;<sup>47</sup> and
- c* audit – the auditor constitutes another level of control of the venture capital fund.

*Insider dealing and market abuse*

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

*Money laundering*

SGPs managing venture capital funds are subject to the standard money laundering and terrorist financing regulations in relation to the investment services they render or when they market, directly or by using an agent, shares or units of OPCVMs.<sup>48</sup>

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43 Articles R214-36 and R214-39 of the MFC.

44 Articles 412-2 and 411-123 of the GR AMF.

45 Articles 412-100 and 412-115 of the GR AMF.

46 Article R214-36 et seq. of the MFC.

47 Articles L214-10 of the MFC and 323-1 et seq. of the GR AMF.

48 Articles 315-50 et seq. of the GR AMF.

### *Short selling restrictions*

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' multi-trading facility.<sup>49</sup>

The disclosure obligation applies to net short positions related to shares admitted to trading on a French regulated market (i.e., NYSE Euronext Paris) or a French 'organised' multilateral trading facility (i.e., Alternext Paris) and for which such market is the reference market.

In addition, the AMF is entitled to take extraordinary measures in the event that exceptional circumstances come to threaten the stability of financial markets.<sup>50</sup> These measures may concern restrictions on the conditions of negotiation of securities, in particular prohibition of short selling regarding certain securities.<sup>51</sup>

### *SICAFs*

#### *Protection of the assets held by a SICAF*

The assets of a SICAF must be entrusted to an investment service provider duly licensed to provide the investment service of custody.<sup>52</sup> The name of the service provider must be indicated in the SICAF's articles of incorporation.

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 recently specified in a decree dated 20 September 2010.<sup>53</sup> The service provider must notably ensure the compliance of the decisions of the SICAF and of the management company.

#### *Regulatory reporting requirements*

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.<sup>54</sup>

### *Specific requirements imposed by French regulations*

#### *Risk*

French regulations do not specifically regulate investment strategies implemented by SICAFs. Risk is therefore controlled through the ratios applicable to the SICAFs and the types of financial instrument that they may purchase.

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49 Article 223-37 of the GR AMF.

50 The AMF took a decision prohibiting short selling regarding certain securities on 11 August 2011, extended on 11 November 2011 for an additional three-month period.

51 Article L421-16 II, MFC.

52 Article L214-150 of the MFC.

53 Decree No. 2010-1100 dated 20 September 2010.

54 Article L214-158 of the MFC.



*Valuation and pricing*

A SICAF must publish its net asset value<sup>55</sup> within eight weeks of the end of each half-year.

**iii Licensing requirements for French venture capital funds and SICAFs**

*Venture capital funds*

French venture capital funds subject to licensing requirements (FCPRs, FCPIs, FIPs) must apply for, and receive, a licence from the AMF before they begin marketing. As a matter of principle, the AMF grants the licence to the French OPCVM within one month of the OPCVM making its application (containing all the requested documents and information) if no problems arise.

Contractual venture capital funds and simplified procedure venture capital funds are not subject to licensing requirements. In this respect, SGPs of such funds must notify to the AMF the creation of the OPCVM within one month of its date of constitution.

*SICAFs*

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.

**IV TAXATION**

**i Funds taxation**

*Venture capital funds*

As a joint ownership structure without legal personality, venture capital funds are not subject to corporate income tax ("CIT").

*SICAFs*

Under certain conditions and during the first three years following their formation, SICAFs benefit from a CIT exemption on capital gains and income derived from their portfolio assets. After this three-year period, listed SICAFs continue to benefit from the full exemption on income and capital gains, whereas non-listed SICAFs only benefit from a CIT exemption for capital gains.

**ii Investor taxation**

*Resident investors*

*Venture capital funds*

Investors in venture capital funds are taxed on the income received from the fund. As these funds are transparent for tax purposes, income that they allocate to investors retains its original nature.

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55 Article L214-56 of the MFC.

Individual investors investing in a venture capital fund benefit – under certain conditions – from an income tax exemption on distributions and capital gains derived from their investment (except for social levies of 15.5 per cent). In addition – under certain conditions – individual investors investing in an FCPI or an FIP are entitled to a tax credit equal to 18 per cent of the subscription price. This tax credit cannot exceed €4,320 for a married couple and €2,160 for a single person.

Tax relief is available for corporate investors in an FCPR, an FCPI or an FIP, although these funds are generally designed for individual investors.

#### *SICAFs*

Distributions received by individual investors from a SICAF are treated as dividends under French tax law. Significant changes occurred during 2012 concerning the tax regime of dividends received by French-resident individuals. As from 1 January 2013, dividends received by individual investors are subject to income tax at progressive tax rates up to 45 per cent, after application of a 40 per cent rebate. Furthermore, in most cases, a 21 per cent mandatory instalment payment on income tax is withheld at the time of the dividend payment (this withholding is offset against the final income tax due for the year). Social levies also apply at the rate of 15.5 per cent.

The gross amount of the distribution may also be subject to an ‘exceptional contribution on high incomes’. This tax is assessed on the fiscal reference income, at the rate of 3 per cent on the part of the fiscal reference income between €250,000 and €500,000, and at the rate of 4 per cent on the part of the fiscal reference income exceeding €500,000 (the thresholds for married couples are respectively €500,000 and €1 million).

The French tax authorities have not indicated if the mark-to-market rules apply to corporate investors in a SICAF.

#### *Non-resident investors*

##### *Venture capital funds*

As venture capital funds are transparent for tax purposes, income that they allocate to non-residents retains its original nature and source. Subject to the provisions of any applicable double taxation treaty, distributions may be subject to a withholding tax in France, at a rate depending on the nature and the source of the income received by the fund, and the country of payment of the income by the fund:

- a* zero per cent for foreign-source income;
- b* zero per cent for French-source interest (unless such interest is paid in non-cooperative jurisdictions; in that case a 75 per cent withholding tax is levied); and
- c* from 15 per cent to 30 per cent for French-source dividend income (75 per cent if it is paid in non-cooperative jurisdictions).

#### *SICAFs*

Subject to the provisions of any applicable double taxation treaty, distribution to non-resident investors is subject to a withholding tax in France, at a rate of 21 per cent for individuals who are tax residents of the European Union or of a Member State of the European Economic Area, and of 30 per cent for other taxpayers.

## **V KEY CHANGES TO THE REGULATORY AND TAX REGIMES**

As regards regulatory aspects, no major changes have been made with respect to the legal framework for fundraising in 2012.

As regards tax, the changes mainly affect the situation of investors through the removal of the 21 per cent flat-rate withholding tax in full discharge of liabilities previously applicable to dividends received by French-resident individuals, and the taxation on the income tax progressive scale of the capital gains derived from the disposal of securities.

No major changes have been made with respect to the taxation of funds. However, it should be noted that the withholding tax on dividends distributed by French-resident companies to foreign OPCs (OPCVMs, OPCIs, etc.) located in the European Union or other states that are signatory to a relevant tax convention have been abolished, further to the CJEU's judgment against such withholding tax on the grounds of the free movement of capital.

## **VI OUTLOOK**

The key challenges for the venture capital industry in France for the near future will likely be the following.

### **i AIFM Directive**

The implementation of the AIFM Directive into French law is expected on 22 July 2013 and will in particular introduce two European passports for European managers of alternative investment funds (i.e., the marketing passport and the management passport).

The combination and coordination of such provisions with provisions of the MiFID and the UCITS IV Directive will represent an important challenge. The UCITS IV and AIFM Directives shall together provide for regulations covering all the collective investment undertakings. Due to the diversity of investment strategies used by alternative investment funds managers, measures to control systemic risk will apply to the actors, in particular alternative investment funds managers and depositaries, rather than to products, as was the case for OPCVMs pursuant to the UCITS IV Directive. Conduct rules provided for by the AIFM Directive and applying to alternative investment funds will be similar to those set forth by MiFID.

Within the framework of such implementation, the addition of a new type of company into French law is being considered, taking the form of a specialised joint stock company that aims to hold at least 50 per cent of unlisted securities and that benefits from specific tax provisions. It could compete with limited partnerships or Luxembourg SICARs.<sup>56</sup>

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<sup>56</sup> 'Implementation of AIFM Directive and harmonisation of financial regulations of institutional investors', working document, Association française des investisseurs institutionnels, 4 January 2013.

**ii Dodd-Frank Act**

The venture capital industry is awaiting the implementing measures of the Dodd-Frank Act,<sup>57</sup> and in particular the exemptions for advisers to venture capital funds, private fund advisers with less than \$150 million in assets under management, and foreign private advisers;<sup>58</sup> and the Volcker Rule, whose deadline for compliance has been postponed until 21 July 2014, as extraterritorial provisions regarding filing and reporting obligations might adversely affect French SGPs. Following proposals made in particular by the European Fund and Asset Management Association and the AFG, in order to minimise the effect of such extraterritorial provisions, the Security and Exchanges Commission accepted the introduction of the concept of ‘reasonable belief’ that the French SGPs should benefit from since they reasonably consider that they do not have any American customers.

On 7 September 2012, the European Fund and Asset Management Association and the AFG requested the exclusion from the scope of ‘covered funds’ of both European UCITS, which are regulated by the UCITS IV Directive, and nationally regulated and supervised funds that are ‘UCITS like’ and similar to US mutual funds, in order to ensure a fair level playing field in relation to US investors, as the Volcker Rule covers all funds but US mutual funds.

**iii Foreign Account Tax Compliance Act**

On 26 July 2012, the United States published a model intergovernmental agreement (‘IGA’) developed in consultation with France, Germany, Italy, Spain and the United Kingdom defining an agreed approach to the Foreign Account Tax Compliance Act (‘FATCA’), enacted on 18 March 2010 and expected to enter into force on 14 January 2014. Pursuant to such IGA, foreign financial institutions within an IGA jurisdiction will not be liable to FATCA withholding and will be able to provide information on their US account holders to their local tax authorities rather than directly to the US. So far, Denmark, Ireland, Mexico, Norway, Spain, Switzerland and the UK have signed or initialled model agreements. The US Treasury is working with more than 50 countries and jurisdictions to implement FATCA. France is expected to enter into such a reciprocal IGA soon, similar to the one already entered into by the UK.

**iv Basel III**

The final version of the Basel III framework was published in December 2010 regarding the reform of prudential standards and providing in particular for an increase in the minimum capital ratio to 7 per cent, which is much higher than the Basel II ratio; the possibility for the national authorities to call for a countercyclical capital buffer (ranging from zero to 2.5 per cent); and the establishment of a leverage ratio set at 3 per cent minimum.

The Basel Committee on Banking Supervision agreed on 7 January 2013 to more flexibility regarding the liquidity coverage ratio provided by the Basel III framework by

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57 Dodd-Frank Wall Street Reform and Consumer Protection Act dated 21 July 2010.

58 The foreign private adviser exemption replaced the private adviser exemption on 21 July 2011.

broadening the type of assets taken into account in the liquidity reserve. The Committee also decided to postpone its implementation until 2019, while it was initially expected in 2015.<sup>59</sup>

v **Solvency II**

The Solvency II Directive<sup>60</sup> was adopted in 2009, providing for a reform of the European regulation of the insurance companies' solvency; it should be implemented on 1 January 2014. The new requirements in terms of capital for insurance companies may affect their global allocation of equity to the venture capital industry.

vi **UCITS V**

On 3 July 2012, the European Parliament and the Council adopted a proposed directive aiming to amend the UCITS IV Directive with respect to the harmonisation of the depositary functions and responsibilities, the remuneration policies regarding OPCVM managers and a common approach regarding the sanctions.<sup>61</sup>

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59 AGEFI, 102 No. 5, 8 January 2013.

60 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of insurance and reinsurance (Solvency II).

61 Proposal 2012/0168 (COD) for a directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

## Appendix 1

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# ABOUT THE AUTHORS

### **STÉPHANE PUEL**

*Gide Loyrette Nouel AARPI*

Gide Loyrette Nouel managing partner Stéphane Puel is a member of the banking and finance department in Paris. He specialises in asset management law and advises French and international financial institutions on setting up and obtaining approval for management companies, and on structuring, setting up, documenting and distributing regulated and non-regulated French and foreign law open-ended and closed-ended investment funds, whether located in France, in other European jurisdictions or offshore.

Mr Puel has gained significant expertise in providing legal advice on structuring and documenting institutional investment funds such as hedge funds, REITs, private equity funds and distressed debt funds. He frequently acts for French and international management companies, advising them on their structure, the regulatory framework governing their business in France, and on distributing French and foreign investment funds. Mr Puel advises these entities on the conduct of business rules applicable to them (human resources, compliance, risk management, etc.) and assists them with court or disciplinary proceedings. Mr Puel is in regular contact with the French Financial Markets Authority on all these issues.

### **JULIEN VANDENBUSSCHE**

*Gide Loyrette Nouel AARPI*

Julien Vandebussche is a senior associate in the banking and finance department at Gide Loyrette Nouel in Paris.

Specialising in finance law and structuring of investment funds, Mr Vandebussche advises French and foreign financial institutions on setting up and obtaining approval for management or advisory companies and on structuring, setting up, documenting and distributing French law open-ended and closed-ended investment funds (private equity funds, infrastructure funds, real estate funds, hedge funds and funds of funds) whether

French (companies, FCPR, contractual UCITS, etc.) or foreign (limited partnerships, GBC1 licensed companies, Luxembourg SICAR, SIF, etc.).

Mr Vandebussche also advises these entities on the rules governing how they do business (human resources, internal control requirements, risk management, anti-money laundering regulations, etc.) and assists them with court or disciplinary proceedings, as well as on the implementation of incentive schemes for their employees (carried interest, performance fees, etc.).

Mr Vandebussche advises funds in relation to certain transactions involving regulatory or deontology issues (guarantees, portfolio transfers, co-investments, etc.) and investors in relation to their initial investment or in secondary transactions.

He is in regular contact with the French Financial Markets Authority on all of these issues.

**GIDE LOYRETTE NOUËL AARPI**

26 cours Albert 1er

75008 Paris

France

Tel: +33 1 40 75 60 00

Fax: +33 1 40 75 69 65

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

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