Employee shareholder investment undertakings: why is there a possible periodic readjustment of the number of units?

Some employee shareholder investment undertakings are invested in the company’s listed securities and may wish their net asset value to reflect the listing value of the company in which they are invested. This choice is usually motivated by the desire to enable the employee, by simple observation of the company’s share price, to know the approximate net asset value of the units of their employee savings plan, even if only the net asset value is valid.

However, the net asset value of the employee investment undertaking and the company’s listing value may differ, especially on the ex-dividend date. The ex-dividends are capitalised in the employee investment undertaking, increasing the net asset value by the same amount and thus making it higher than the company’s share price.

Conversely, the net asset value of an employee shareholder investment undertaking partially invested in the company’s listed securities (for example 90%, with the balance invested in money market funds) will fall below the company’s share price in a bull market because it will not be able to capture the full increase in share price.

To correct this difference, an operation qualified as a “readjustment” or “recorrelation” between the share price and the fund net asset value may be carried out.

In this month’s paper, I will explain the reasons for, and consequences of, such an operation, which is often little known or poorly understood.

## The Facts

An employee of Company X, Mr. S., has an employee savings plan and holds 1,000 units of fund A which is invested mainly in securities of company X.

By reading information on his account holder’s website, he learned that on 15 November 2018, there had been a “recorrelation” operation to restore the match between the value of the units in fund A and the share price of X.

Considering that this operation might be detrimental to him, Mr. S. sent a claim to his account holder.

He argued that although this revaluation did not change the amount of his assets at the time of the readjustment – given that the stock exchange was closed – this was no longer the case once the stock exchange had opened. This is because, at that time, the price of the unit, which was aligned with the share price, fell back to the previous day’s price, which, according to Mr. S, resulted in an immediate loss for all unitholders.

He made the following observation to support his claim:

* On 15 November 2018: after the recorrelation, the price of the unit was €14.72 (instead of €14.62181), and the number of units that he held was reduced by 6.671 units. He was therefore left with 993.329 units (instead of 1000).
* On 16 November 2018: the price of the unit, aligned with the price of the X share, returned to the previous day’s price of €14.62, leading to an immediate loss of €97.53 (€14.62 x 6.671 units).

After receiving an answer that he considered unsatisfactory, this client therefore requested my intervention to make his account holder restore his employee savings scheme to its original state and to return the units that had been cancelled.

## The Investigation

I began by examining the regulatory documentation of the fund and noted that fund A’s investment objective is *“to replicate the performance of the X share”*. This fund is approved by the AMF and invests between 90% and 100% of its assets in X shares and up to 10% of its assets in UCITS classified as "money market” and/or “short-term money market” funds. It is also specified that the net asset value will increase or decrease according to the price of the X share.

The fund prospectus also states that *“to limit any disparity that may appear between the net asset value of the unit and the price of the X share, the number of shares may be readjusted”.*

**What is a readjustment (or recorrelation) operation?**

When there is too large a difference between the net asset value of the unit and the share price, a readjustment must be made to adjust the value of the fund unit to the share price.

The readjustment is similar to a classic corporate action that does not require AMF authorisation, especially since this adjustment is provided for in the fund regulations.

In this case, to realign the unit price on the X share price, a recorrelation was carried out on 15 November 2018. The number of units of the fund was readjusted and the revalued net asset value thus realigned the value of the unit with the X share price. After this operation, the value of the unit of the fund A was therefore equal to the opening price of the X share, i.e. €14.72.

I explained to Mr. S., as he himself acknowledged, that this operation was neutral at the time the readjustment was made and had had no impact on the overall valuation of his investment. **This is because, after the operation, although the investor has fewer units, the value of each unit is increased accordingly.**

To support my analysis, I performed several comparisons for Mr. S over time. The first analysis consisted in examining his portfolio status before and after readjustment. It turned out that the overall valuation was strictly identical:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Before readjustment** | | | **During the readjustment on 15/11** | | |
|  | *Value of the unit (€)* | *Number of units* | *Total valuation (€)* | *Value of the unit (€)* | *Number of units* | *Total valuation (€)* |
| Fund A | 14.62181 | 1000 | **14,621** | 14.72 | 993.329 | **14,621** |

Supporting my reasoning with figures, I also explained to Mr. S. that the valuation displayed by his portfolio the day after the readjustment (€14,522) - the date he used to consider that the operation was detrimental – was higher than the valuation displayed a few days before the readjustment (€13,850).

Lastly, after analysing the history of the fund’s net asset values since the readjustment, I pointed out that at the highest level, the unit of fund A had been valued at €15.25 on 3 December 2018, and there again, the valuation of his portfolio (€15,148) was higher than the valuation observed on the day before the readjustment (€14,702).

## Recommendation

In conclusion, in view of all these calculations, I informed the investor:

* on one hand, that the readjustment operation *per se* had not been detrimental to him: although he did indeed hold fewer units, the value of each unit had been increased accordingly;
* on the other hand, that the differences observed in the following days resulted solely from fluctuations in the X share price - and therefore in the net asset value of the fund. He would therefore have been affected in the same manner if there had been no readjustment, given the inherent uncertainty of financial markets.

I therefore informed Mr. S. that I had no grounds to take further action with his account holder to restore his employee savings scheme and could therefore not accede to his request.

## Lesson to be Learned

It should be remembered that the fund regulations provided to investors constitute the reference document providing information about the characteristics of the fund, as well as about any events liable to affect the life of the fund. Investors must therefore acquire the reflex of consulting them whenever they have a question after their subscription.

It is nevertheless understandable that this type of operation, which is complex in many respects, is difficult for investors to understand. This complexity is the downside of the desire to be able to display a net asset value that is close to the company’s market price. Investors must be aware that this readjustment is provided for in the regulations and is carried out in order to be in line with the investment objective. It aims to ensure that the net asset value of the fund continues to be correlated with the share price.