

Chapter IV – Investment Service Providers and Investment Management

	Decisions	1999	2000	2001	2002	2003	
Investment management	Authorisations granted to asset management companies	42	62	59	36	33	
	– <i>Portfolio management companies</i>	37	58	56	33	30	
	– <i>Fund management companies</i>	5	4	3	3	3	
	Funds authorised (total)	1,073	1,267	1,354	1,204	1,033	
	– <i>Open-end investment companies (SICAVs)</i>	57	112	44	27	28	
	– <i>General-purpose unincorporated investment funds (FCPs)</i>	732	843	967	826	697	
	– <i>Venture capital funds (FCPRs)</i>	55	54	35	37	34	
	– <i>Employee investment funds (FCPEs)</i>	222	255	303	312	272	
	– <i>Funds investing in futures and options (FCIMTs)</i>	7	3	5	2	2	
	Funds declared via simplified procedure	257	261	213	189	177	
	Authorisations granted for transformation of a fund	2,422	2,104	1,797	2,586	3,792	
	Authorisations granted to UCITS *	524	609	503**	461	402	
Other	Visas issued for debt securitisation funds (FCCs) and subfunds	7	4	8	7	6	
	Visas issued for real estate investment trusts (SCPIs)	8	14	12	10	45	
	– <i>Opened to the public</i>	2	2	1	1	2	
	– <i>Capital increase</i>	-	4	-	0	0	
	– <i>Change in price, updated prospectus</i>	6	8	11	9	43	
	Visas issued for film production finance vehicles (Sofica)	9	8	9	6	10	
	– <i>Newly established</i>	7	5	6	4	10	
	– <i>Capital increase</i>	2	3	3	2	0	
	Visas issued for fishing industry finance vehicles (Sofipêche)	-	8	7	4	4	
	– <i>Newly established</i>	-	7	7	4	4	
	– <i>Capital increase</i>	-	1	-	0	0	
	Other investment service providers	Approval of programme of operations	39	48	43	28	26
– <i>Extension of programme of operations</i>		10	15	14	13	7	
Refusal of proposed programme of operations		2	1	1	1	1	
– <i>Refusal of proposed extension</i>		0	0	0	1	0	
Authorisation to provide custody account-keeping		490	14	14	14	18	
Use of European passport to conduct business in another state of the European Economic Area							
– <i>Freedom of establishment</i>		8	13	12	8	5	
– <i>Freedom to provide services</i>		165	180	125	73	8	
Use of European passport to conduct business in France							
– <i>Freedom of establishment</i>		10	15	13	12	5	
– <i>Freedom to provide services</i>		136	134	187	140	89	

Source: AMF

* Undertakings for Collective Investment in Transferable Securities or their subfunds. UCITS are funds that comply with the terms of Directive 85/611/EEC of 20 December 1985

** revised figures

I – Investment service providers

The Financial Security Act of 1 August 2003 simplified the licensing regime for investment service providers by establishing a new division of responsibilities between the Comité des Établissements de Crédit et des Entreprises d'Investissement (CECEI) and the Autorité des marchés financiers (AMF).

Previously, to offer investment services, providers were required to obtain authorisation from the CECEI after their programme of operations had been approved by the Conseil des Marchés Financiers (CMF) for each service.

If the service in question involved asset management, the programme of operations had to be approved by the Commission des Opérations de Bourse (COB), with the assent of the Comité Consultatif de la Gestion Financière (CCGF).

If portfolio management was the provider's principal activity, the authorisation was issued not by the CECEI but by the COB, with the assent of the CCGF, and was issued in the name of the management company.

Under the Act, the AMF inherits the powers of the COB, authorises portfolio management companies, and approves the programmes of operations of other service providers whenever they provide an asset management service. The other investment services that were previously under the jurisdiction of the CMF must now be authorised the CECEI, with the assent of the AMF.

A – Investment management companies

After peaking at 534 at 31 December 2002, the number of investment management companies in active operation declined slightly in 2003, ending the year at 509.

1 – Authorisations and approvals granted in 2003

In 2003 the COB, and then the AMF, issued new authorisations to 30 portfolio management companies and three fund management companies. Between them, these 33 companies presented 52 programmes of operations. In addition, approval was given to 32 programmes of operations presented by 26 previously authorised firms: 25 portfolio management companies and one fund management company.

2 – Programmes of operations and resource suitability

As a condition for AMF authorisation, asset management companies must have a programme of operations. This programme must be appropriate to the range of activities envisaged and must be regularly updated.

For the AMF, the programme of operations serves two purposes:

- It enables the Authority to ascertain beforehand, based on the provider's declared intentions, whether the authorisation criteria are met, thus complementing the on-site inspections that the AMF conducts subsequently. By reviewing the programme of operations on a series of key points, the AMF can assess whether the company's activities, organisation and resources are consistent with its capacity to manage the risks (operational risk, market risk, regulatory risk, etc.) inherent in the business it proposes to conduct. Afterwards, it is necessary simply to verify that the programme has actually been implemented. This approach naturally leads the AMF to tailor the checks it performs to the type of management activity set forth in the programme.
- The review of the programme of operations entails the exchange of information between the provider and the AMF at an early stage. It also ensures that questions relating to the provider's organisation and resources are not raised in subsequent fund-authorisation procedures, which should be simple, quick to implement and focused on full disclosure to investors.

3 – “Alternative multi-management” programmes

At 1 January 2004 the AMF had approved 12 programmes of operations relating to the use of alternative funds not recognised in France. The companies in question were engaging in this activity for the first time.

4 – Use of credit derivatives

Since December 2002, companies making use of credit derivatives must obtain prior approval from the regulator of a specific programme of operations that complies with point 1 of Article 4-6 of Decree 89-623.

The COB established the contents of these programmes in early 2003 and provided further details in the October 2003 edition of its monthly bulletin. The content requirement is consistent with the policy recommendations of the working group formed in 2002 to determine the conditions for the use of credit derivatives by asset management companies. These recommendations were adopted by the CCGF when it examined the first 18 programmes filed.

5 – Use of complex derivatives

Prompted by the increase in the number of structured (or “formula-based”) funds, the regulator introduced a ruling on 1 January 2002 requiring management companies that have created at least one such fund to update their programme of operations. In 2003, the COB received 26 structured-fund programmes, which have been incorporated into the management company’s overall programme of operations. Accordingly, new funds falling within the scope of operations described in the programme can generally be authorised without further requests for information about the company’s resources.

6 – Expiry or withdrawal of authorisation

The COB, and subsequently the AMF, withdrew the authorisations – or recorded the expiry thereof – of 35 portfolio management companies and 23 fund management companies in 2003.

B – OTHER INVESTMENT SERVICE PROVIDERS

For various reasons, the regulatory authorities took a number of individual decisions concerning investment service providers in 2003.

In the case of the CMF, these individual decisions consisted either in:

- approving a programme of operations or an extension of the programme of operations,
or
- authorising the provision of custody account-keeping services for financial instruments

The CMF also examined a number of cases relating to the use of the European passport by French-incorporated investment service providers seeking to operate in another state of the European Economic Area, and reciprocally by firms from other European states seeking to provide investment services in France.

In the case of the COB, these individual decisions consisted in approving extensions of programmes of operations for portfolio management, submitted by investment service providers other than portfolio management companies.

1 – Approvals of programmes of operations

In 2003, 23 requests for authorisation or extension of authorisation were forwarded by the CECEI to the CMF for approval. In addition, two requests for approval of extensions of portfolio management programmes were sent to the COB.

Five of the applicants were seeking approval as credit institutions and 19 as investment firms.

The approvals granted by the CMF and the COB in 2003 for programmes of operations or extensions thereof are shown in the table below.

The investment services are those listed in Article L. 321-1 of the Monetary and Financial Code:

- 1) Receiving and transmitting orders for third parties
- 2) Executing orders for third parties,
- 3) Trading for own account
- 4) Portfolio management for third parties
- 5) Underwriting
- 6) Placement.

The financial instruments are those listed in Article L. 211-1 *ibid.*

- 1 - Shares and other securities that afford or may afford direct or indirect access to equity or voting rights, transferable by book entry or by physical delivery
- 2 - Debt securities transferable by book entry or by delivery, each representing a claim on the legal person which issues it, other than trade bills and *bons de caisse*
- 3 - Units or shares in collective investment undertakings
- 4 - Financial futures

Approval of programmes of operations in connection with restructuring			
Company name	Requested status	Investment services	Financial instruments
Caisse Régionale de Crédit Agricole Mutuel Centre France	Credit institution	1) - 2) - 3) - 5) - 6)	1 - 2 - 3 - 4
Crédit Agricole Titres	Investment firm	1)	1 - 2 - 3
Approval of programmes of operations in relation to regulations governing employee savings schemes			
Company name	Requested status	Investment services	Financial instruments
AXA Epargne Entreprise	Investment firm	1)	1 - 3
CIC Epargne Salariale	Investment firm	1)	1 - 2 - 3
Crédit Mutuel Participation	Investment firm	1)	1 - 2 - 3
Fédéris Epargne Salariale	Investment firm	1)	1 - 2 - 3
Fongépar	Investment firm	1)	1 - 2 - 3
Natexis Interépargne	Credit institution	1) - 6)	1 - 2 - 3
OJH-Novacy	Investment firm	1)	1 - 2 - 3
Prado Epargne	Investment firm	1)	1 - 3
Regard BTP	Investment firm	1)	1 - 2 - 3
Approval of programmes of operations of new entities			
Company name	Requested status	Investment services	Financial instruments
MPE Finances	Investment firm	1) - 2)	1 - 2 - 3 - 4
Banque NSM Entreprises	Credit institution	1)	1 - 2 - 3
Marveyre Gestion Privée Entreprise d'Investissement	Investment firm	1)	1 - 2 - 3 - 4
Vizille Capital Finance	Investment firm	5) - 6)	1 - 2 - 3 - 4
Approval of programmes of operations of entities already operating in the financial sector			
Company name	Requested status	Investment services	Financial instruments
H et Associés S.A.	Investment firm	1)	1 - 3
Parel	Investment firm	1) - 2)	1 - 2 - 3 - 4

Extension of programmes of operations			
Company name	Requested status	Investment services/ Clearing-related service	Financial instruments
C@pitol	Extension of authorisation – investment firm	2) - 3) - 6) Clearing	N/A
CA-IS Corporate Trust	Extension of authorisation – investment firm	2)	N/A
Crédit Coopératif	Extension of authorisation – credit institution/ investment service provider	2) - 3)	N/A
Dexia Securities	Extension of authorisation – investment firm	3)	N/A
HPC	Extension of authorisation – investment firm	3)	N/A
Marveyre Gestion privée	Extension of authorisation – investment firm	4)	N/A
Banque Cantonale de Genève (France)	Extension of authorisation – credit institution	4)	N/A

Source: AMF N/A: Not Applicable

2 - Authorisations to carry on the business of custody account-keeping for financial instruments

In 2003 the CMF granted 18 authorisations for custody account-keeping: seven to credit institutions, nine to investment firms and two to other entities recognised neither as credit institutions nor as investment firms but entitled to a waiver pursuant to the second indent of Article 6.2.2 of the CMF's General Regulations.

Authorisations to perform custody account-keeping granted at the same time as an authorisation to provide investment services		
Company name	Status	Remarks
AXA Épargne Entreprise	Investment firm	Custody account-keeping for an employee savings scheme
Banque Banorabe	Credit institution	
Banque NSM Entreprises	Credit institution	
Caisse Régionale de Crédit Agricole Mutuel Centre France	Credit institution	
CIC Epargne Salariale	Investment firm	Custody account-keeping for an employee savings scheme
Crédit Agricole Titres	Investment firm	
Crédit Mutuel Participation	Investment firm	Custody account-keeping for an employee savings scheme
Fédéris Epargne Salariale	Investment firm	Custody account-keeping for an employee savings scheme
Fongépar	Investment firm	Custody account-keeping for an employee savings scheme
Natexis Interépargne	Credit institution	Custody account-keeping for an employee savings scheme
OJH - Novacy	Investment firm	Custody account-keeping for an employee savings scheme
Prado Epargne	Investment firm	Custody account-keeping for an employee savings scheme
Regard BTP	Investment firm	Custody account-keeping for an employee savings scheme

Authorisations to perform custody account-keeping requested by entities already authorised as credit institutions		
Company name	Status	Remarks
Banque Cantonale de Genève (France) S.A.	Credit institution	Not an investment service provider
Banque Fédérale Mutualiste - BFM	Credit institution	Investment service provider
BLC Bank (France) S.A.	Credit institution	Investment service provider
Authorisations to perform custody account-keeping by derogation		
Company name	Status	Remarks
BNP Paribas Épargne Entreprise	“Pure” custody account-keeper	Authorised pursuant to 2 nd indent, Article 6.2.2 of the General Regulations of the CMF
Crédit Agricole Épargne Longue des Salariés (CA-ELS)	“Pure” custody account-keeper	Authorised pursuant to 2 nd indent, Article 6.2.2 of the General Regulations of the CMF

b) Changes brought about by the Financial Security Act

The Act has enshrined the status of custody account-keeper. Article L. 542-1 of the Monetary and Financial Code now lists, under the heading of intermediaries entitled to perform custody account-keeping, “legal entities established in France having as their principal or sole business purpose the custody or administration of financial instruments”.

The Act has also overhauled the regime for authorising the business of custody account-keeping for financial instruments, bringing it into line with the requirements applicable to investment service providers.

The minimum capital requirement for custody account-keepers is now set by the Minister of the Economy, Finance and Industry, with the assent of the consultative committee on financial legislation and regulation (CCLRF).

Regulation and supervision of the other operating conditions for this activity, in particular the rules of conduct, come under the jurisdiction of the AMF.

On 2 February 2004, the CECEI started web-posting the list of institutions authorised to perform the function of custody account-keeper for financial instruments (www.cecei.org).

3 – Fund custodians

At 31 December 2003 there were 88 institutions offering fund custody services.

Large financial institutions dominate the rankings of custodians. The 22 largest custodians account for 90% of assets under management and 76% of all funds.

Under the Financial Security Act, operating conditions for the business of providing custody services to collective investment schemes are to be set forth in the AMF’s general regulations. The issuance of these regulations will thus provide the opportunity for the regulator to spell out the requirements applicable to custodians and to update the content of the COB’s 1993 instruction on the role and resources of custodians. This will ultimately strengthen the legal framework governing custody, thereby enhancing its contribution to investor security.

4 – European passport

a) Use of the European passport in another state party to the agreement on the European Economic Area

Notification of freedom of establishment

In 2003 five such notifications were reviewed favourably by the CMF. They were received from two investment firms and three credit institution providing investment services, and they concerned three other Member States of the European Economic Area (EEA): Germany (3), Spain (1) and Portugal (1).

Two kinds of reasons prompted these notifications:

- Substitution of a branch office for a pre-existing business presence. Four entities (two credit institutions and two investment firms) wished to substitute a branch office of an EU-wide business for a pre-existing local non-bank branch, subsidiary or other group entity.
- Creation of a branch office as part of a merger. Concomitant with its acquisition of regulated French-incorporated entity, a credit institution wished to take over, in its own name, the activities previously carried on by the acquired entity through a branch office in Spain. The acquirer therefore notified the CMF that it was exercising freedom of establishment.

Declaration of freedom to provide services

During 2003 eight such declarations by six investment service providers (ISPs) were brought to the attention of the CMF.

These six ISPs consisted of:

- three credit institutions
- three investment firms

The eight declarations concerned only five Member States: Austria (2), Greece (1), Ireland (1), Italy (1) and the United Kingdom (3).

b) Use of the European passport in France

Notification of freedom of establishment

In 2003 five such notifications from ISPs authorised in another Member State of the EEA were brought to the attention of the CMF.

These five ISPs consisted of:

- one credit institution
- four investment firms

The notifications came from ISPs in two Member States: Belgium (1) and the United Kingdom (3).

Three of the five branch offices in question were opened during 2003:

- one branch office of a credit institution/ISP that took the place of a French-incorporated subsidiary whose authorisation had been withdrawn;
- two branch offices of investment firms: one new, the other replacing a representative office in Paris.

Declaration of freedom to provide services

In 2003, 89 such declarations from investment service providers authorised in another Member State of the EEA were brought to the attention of the CMF.

These declarations came from:

- 27 credit institutions
- 62 investment firms

The 89 declarations came from ISPs of 15 Member States: Germany (11), Belgium (1), Denmark (1), Spain (1), Finland (1), Greece (2), Ireland (3), Italy (3), Liechtenstein (1), Luxembourg (7), Norway (1), Netherlands (7), Portugal (6), United Kingdom (42) and Sweden (2).

C – CHANGES IN THE REGULATORY FRAMEWORK

1 – Qualifications of managers and persons in charge of determining investment policy at management companies

The COB published its interpretation of Articles L. 532-9.4 and L. 532-9.5 of the Monetary and Financial Code relating to persons responsible for managing and determining investment policy at asset management companies.

The actual running of the company, that is, general management and representation of the company to third parties, must be carried out by at least two persons having the status of executive officer under French company law. This means:

- for limited joint-stock companies (*sociétés anonymes*) with a board of directors or executive board: the managing director and deputy managing directors
- for partnerships limited by shares (*sociétés en commandite par actions*), commercial partnerships (*sociétés en nom collectif*) and ordinary limited partnerships (*sociétés en commandite simple*): the managing partners
- for simplified joint-stock companies (*sociétés par actions simplifiées*, SAS): the chairman, a managing director or a deputy managing director named in the articles of association

In addition to requiring that two persons of integrity and suitable experience actually manage the company, the law requires that at least two persons should determine its investment policy. Executive officers are *ipso jure* in charge of the company's policies. The AMF allows a management company's investment policy to be determined by a person who is not an executive officer of the company, under the following conditions:

- The person has operating responsibilities within the company.
- The person is appointed to perform this function alongside an executive officer.
- The appointment specifies the person's operating responsibilities, which must be identical to those of the executive officer.
- The appointment is made, and can be revoked, by the body responsible for designating the company's executive officers (or by the articles of incorporation in the case of an SAS).

2 – Delegation of financial management

Recent trends in the investment management industry are resulting in an increase in delegated management.

While the regulator has recently set out the conditions in which financial management can be delegated for the purpose of alternative multi-management, many international financial groups are now reorganising on a European scale in order to rationalise their production processes and achieve economies of scale. This trend is prompting corporate groups to set up management units specialised in specific asset classes; the group's locally based investment management companies then delegate the management of those classes to the appropriate unit.

The reason for delegating financial management is generally to enable the company's clients (fund unit-holders or discretionary management clients) to benefit from another company's expertise in a highly specialised asset class. For example, a company managing an international equity fund may delegate management of the fund's Asian portfolio to a company specialised in that region. The value added by the delegating company thus lies in its ability to select the specialised management company and oversee what it does with the segment of the portfolio entrusted to it.

In Article 1.15 of its instruction of 17 December 1996 and chapter II of its instruction of 15 December 1998, the COB defined the conditions in which a management company may delegate the financial management of assets under discretionary management. It further clarified these conditions in numerous case of delegated management submitted for regulatory authorisation in respect of two areas: approval of the delegating company's programme of operations, and approval of delegated management of more than 30% of a fund's total assets.

Three of the conditions laid down in COB instruction of 17 December 1996 must be noted: the delegation must comply with the authorisation granted to the delegating company; the principle that the company must have adequate resources at all times continues to apply; and the company must exercise effective supervision of the delegated activity.

Because the types of delegation are so diverse, they must be examined on a case-by-case basis. To cover the case in which a management company delegates a substantial portion or the majority of the assets under management, a combination of quantitative and qualitative criteria are used:

- quantitative: annual revenue and total assets of the delegated funds
- qualitative: whether the management company has retained the ability to oversee the delegated activity and to fulfil its responsibilities to its investors

The special case of financial management being delegated to a parent company has prompted the regulator to impose the following conditions:

- the parent company must provide a comprehensive internal control plan, which is updated annually and incorporated into the delegation agreement
- the delegation agreement must also contain details of the delegatee's obligations to inform the delegator when an anomaly is detected by the former's internal control process.

In this case, it is essential that the subsidiary company be involved in drawing up the control plan and overseeing its implementation. Moreover, the delegating company's responsibility to the investor remains undiminished.

II – General funds

The AMF, having taken over the regulatory jurisdiction of the COB, has sole responsibility for authorising the formation, transformation, merger, demerger or liquidation of collective investment funds.

In determining whether to grant authorisation, the AMF looks to see whether the fund itself is financially sound and complies with legal and regulatory provisions. To this end, it verifies the information contained in the prospectus (superseded by the "simplified prospectus") drawn up by each fund to be given to prospective investors.

A – GENERAL-PURPOSE PRODUCTS: AUTHORISATIONS IN 2003

New funds authorised in 2003, by category

Classification	Number of funds authorised in 2003	% of total	Assets of funds authorised in 2003	% of total	Assets of all funds in this category as a percentage of aggregate funds assets** at 31/12/2003
French equities	14	1.9%	0.5	1.2%	5.1%
Equities of other euro-area countries	37	5.0%	2.8	6.7%	3.5%
Equities of other European Union countries	38	5.2%	0.6	1.4%	1.9%
International equities	71	9.8%	3.0	7.2%	6.5%
Euro-denominated bonds/other debt securities	79	10.9%	5.9	14.1%	10.7%
International bonds/other debt securities	18	2.5%	0.7	1.7%	7.3%
Euro money market	33	4.6%	10.0	23.9%	36.0%
International money market	NM	NM	NM	NM	0.1%
Diversified	253	34.9%	8.7	20.8%	22.4%
Guaranteed or protected	182	25.1%	9.7	23.2%	6.4%
Total	725	100%	41.9	100%	100%
<i>Source: AMF</i>					
<i>N/M: Not meaningful * € billion ** including feeder funds</i>					

For the second consecutive year, there was a decline in authorisations issued by the regulator: in 2003 that number was down 15% compared with 2002. During the year, 725 new funds were licensed, 697 as unincorporated funds (FCPs) and 28 as open-end funds (SICAVs).

Funds declared via simplified procedure at 31 December 2003, by category

Classification	Number of funds	Assets at 31/12/2003	Assets as % of total
French equities	1	0.1	<i>0.1 %</i>
Equities of other euro-area countries	10	0.6	<i>0.9 %</i>
Equities of European Union countries	4	0.2	<i>0.3 %</i>
International equities	33	1.2	<i>1.7 %</i>
Euro-denominated bonds/other debt securities	61	2.3	<i>3.3 %</i>
International bonds/other debt securities	20	29.9	<i>42.8 %</i>
Euro money market	31	9.3	<i>13.3 %</i>
International money market	4	0.3	<i>0.4 %</i>
Diversified	363	23.0	<i>33.0 %</i>
Guaranteed or protected	110	2.9	<i>4.2 %</i>
Total	637	69.8	100 %
Source: AMF	<i>Assets under management in € billion</i>		

1 – Funds investing in futures and options (FCIMT)

At 31 December 2003, 28 funds investing in the futures and options markets were in active operation, compared with 29 the year before. Two new funds were created and three were dissolved. Total assets under management in FCIMTs were up 16.2% to €971.9 million in 2003, compared with €836.3 million in 2002.

2 – Authorisations to market funds established under foreign law

At 31 December 2003, 3,052 Undertakings for Collective Investment in Transferable Securities (UCITS) (or their subfunds) authorised in other European countries had received marketing authorisation from the French regulator and could be offered for sale in France. This total represented 76 funds without subfunds and 226 umbrella funds with an average of 12 subfunds each.

In 2003 the regulatory authority granted 402 marketing authorisations, down from 461 the year before. The breakdown by country of origin shows that Luxembourg still accounts for the bulk of requests (74%). Also notable is an increase in requests from Ireland (24%) and a decrease in requests from the United Kingdom.

A – GENERAL-PURPOSE PRODUCTS: ASSETS UNDER MANAGEMENT

In line with the trend reversal in the markets in 2003, assets under management (AUM) in general funds showed renewed growth, with a rise of nearly 12.5% on the year, from €749.6 billion at year-end 2002 to €843.6 billion (excluding assets held in feeder funds) at 31 December 2003. This rise reflects:

- a price effect of 6%, due mainly to gains in equity markets
- a net inflow effect of 6.5%, down slightly from the year before. The decline was attributable mainly to lower inflows into money-market funds.

Including assets held in feeder funds, total net AUM posted an increase of 13.2%, from €803.1 billion at year-end 2002 to €909.4 billion at year-end 2003.

The number of products registered in France continued its moderate growth. At 31 December 2003 there were 7,906 general funds, of which 1,108 SICAVs and 6,798 FCPs. The number of SICAVs decreased by 69 compared with 2002, and AUM shrank by 0.8%. In contrast, the number of FCPs increased by 184. FCPs now represent 86% of the products and 68% of AUM in general funds.

III – Legal and regulatory framework applicable to general funds

A – IMPLEMENTATION OF THE RECOMMENDATIONS OF THE WORKING GROUP ON FEES, WORK ON FINANCIAL INNOVATION, AND TRANSPOSITION OF THE EU DIRECTIVE

Under European Union directive 85/611/EEC any collective investment scheme conforming to its provisions (and thus said to be “harmonised”) qualifies as an Undertaking for Collective Investment in Transferable Securities (UCITS). As such, it may be marketed in all the Member States under a declaration of conformity granted by the national regulator of its home country.

This directive had become obsolescent and was in need of amendment. Directives 2001/107/EC and 2001/108/21/EC, adopted 21 January 2002, radically overhauled the existing provisions by introducing regulations relating to asset management companies and simplified prospectuses (directive 2001/108/EC) and amending the provisions relating to UCITS investments (directive 2001/108/EC).

These new provisions were transposed by France in 2003. At the same time, the legal framework for UCITS was modified to incorporate the recommendations of the working group on fees, along with the conclusions drawn from the industry consultations on financial innovation (alternative funds of funds, structured funds and credit derivatives).

Transposition of these directives entailed amendments to the following laws and regulations:

- Monetary and Financial Code, amended by the Financial Security Act of 1 August 2003
- Decrees 89-623 and 89-624
- COB Regulations 96-03 and 89-02
- COB instruction relating to the full prospectuses of UCITS

1 – The European standard

The amended texts establish a minimum set of rules that comply with the UCITS directives and are intended to protect individual investors. Although this standard draws heavily on existing provisions, it differs from them on the following points:

Investment rules

- The types of financial instrument that can be held as assets of a UCITS are now specified exhaustively in Articles 1 and 3 of Decree 89-623. Money-market instruments are now eligible as such, whereas previously they could be held only if they were equivalent to listed transferable securities. Deposits are likewise eligible for inclusion in a UCITS’ assets; thus, funds are no longer restricted to holding cash on an incidental basis only.
- The investment rules have been fine-tuned to reflect advances in asset management techniques. For certain ratios, both underlying assets and derivatives based on them are taken into account. Issuers belonging to the same group are consolidated in the calculation of risk-spreading ratios. Ratios have been introduced for deposits and funds of funds. The new rules also allow index funds and funds of funds to qualify as UCITS.

- The explicit eligibility of deposits, money-market instruments and derivatives has made it necessary to set precise rules governing the use of these products.
- The recasting of Decree 89-623 provided the opportunity to clarify the rules applying to "temporary acquisitions and disposals of securities" (i.e. stock loans and repurchase agreements), even though this subject is not addressed by the directive. Temporary disposals of financial instruments may now amount to as much as 100% of a UCITS' assets, whereas temporary borrowings remain limited to 10%. That limit is raised to 100% under certain conditions, notably to allow money-market UCITS to continue using securities repurchase agreements.

Disclosure to investors

- The ways in which information is provided to subscribers have been improved. The *notice d'information* has been replaced by a full prospectus consisting of a memorandum, or detailed note, and a simplified prospectus. As it was, the *notice d'information* served a twofold purpose: to inform the investor about the essential characteristics of the product, and to establish the legal framework within which the UCITS would be managed. In contrast, the simplified prospectus and the detailed note are each intended to meet different objectives: the first provides an accessible, plainly stated informational summary to potentially unsophisticated investors, and the second gives precise, exhaustive technical details.
- The prescribed content of the detailed note reflects the requirements of the directive and the recommendations of the working group on fees. It builds on the conclusions of a European working group established by the UCITS Contact Committee in 2003. The main improvements relate to the following:
 - The description of the fund's management objective and investment policy, which must indicate clearly how the financial instruments in question will contribute to the objective.
 - Disclosure of fees charged to the UCITS. In addition to the information on maximum fees provided by the intermediary in advance, the new texts require disclosure of fees actually charged to the UCITS, taking into account any commissions and fees of collective schemes in which the UCITS has invested. This requirement takes into account the recommendation of the European Commission, which calls for *ex post* disclosure of a metric of total operating expenses called the Total Expense Ratio (TER), which is close to the concept advocated in the COB's report on fees.
 - Inclusion of information on past performance.

Categories of fund units and closure of subscriptions

- The Financial Security Act introduced the possibility of a UCITS issuing different categories of units. The rules governing such issuance were set down by the COB in Regulation 89-02. These rules came into force on 1 April 2004 and are expected to foster rationalisation and enhance productivity in France's fund management industry.
- The Act also introduced the possibility of a UCITS being closed to new subscribers. The conditions governing such closure have likewise been specified in Regulation 89-02. The provisions on this matter are designed to meet three objectives:
 - Clarify the conditions on which funds with time windows for subscription – e.g.; structured funds – may be marketed.

- Provide a firmer legal foundation for the regime applicable to dedicated funds. The regulation reaffirms that, except for UCITS reserved for no more than 20 holders or for a single category of investor, a fund may be closed only on the basis of objective criteria such as reaching a maximum number of units or shares issued or a maximum amount of assets under management, or the expiry of a predetermined subscription period.
- Allow a fund to close to new subscribers as a result of investment management considerations (for example, to cap assets under management).

Rules of conduct for investment managers

- The terms and conditions for the remuneration of service providers have been clarified. A management company may not receive rebates of management fees or subscription/redemption commissions in return for an investment by UCITS under its management in other UCITS. Furthermore, the conditions under which a management company may charge variable management fees have been formalised. In particular, the rules now state explicitly that the way in which variable management fees are calculated must be consistent with the investment objective of the portfolio and must not lead the company to take excessive risks in managing those assets. Lastly, the rules for fees earned on stock loan transactions in securities held in the portfolios under management have also been clarified.
- The substance of the best-execution principle has been made clear. Investment managers are reminded that they must implement a formal, auditable procedure for selecting intermediaries and service providers.

2 – Standards specific to France

The directive allows Member States to heed requests put forward by their domestic asset management industry and investors. Thus, France's Financial Security Act has established some new fund categories.

Funds accessible to all categories of investor

- Funds of funds with a statutory dispensation allowing them to invest up to 50% of their assets in units or shares of other UCITS, whereas for harmonised funds of funds that ratio may not exceed 20%.
- Master-feeder funds.
- Actively managed index-linked funds that are entitled to waive the risk-spreading rules applicable to index funds, provided their investment objective is tied to the performance of an index by means of a maximum tracking error.

Funds accessible to certain categories of investors only

- Funds authorised to operate under streamlined investment rules, including alternative funds of funds
- Contractual funds not authorised by the AMF but registered with it

Management companies wishing to operate funds in these two categories must obtain prior approval of a specific programme of operations from the AMF.

3 – Outlook

The framework put in place in 2003 will be expanded and clarified in the following areas.

- In conjunction with the industry, decree 89-623, which applies to the calculation of funds' off-balance sheet commitments and the computation of tracking error thresholds for index and indexed-linked funds and derivatives, will be reviewed in order to clarify its scope and the associated implementing rules.
- The Europe-wide approach to investment management issues must be strengthened. It must take account of efforts currently under way at EU level, notably in the form of draft recommendations. Most importantly, it must extend the work done through the Committee of European Securities Regulators to foster a true single European market in investment management – a market that is open, competitive, transparent and founded on a high level of investor protection. Lastly, the provisions of the Management Directive have yet to be implemented.

B – MAIN DEVELOPMENTS IN PRODUCTS

Regulatory projects have provided the basis for a broad-based consultation aimed at redefining the product offering of the collective investment management industry in France, taking the directive as the basic standard and building on what the industry has already achieved.

Examples are given in this section for the following product categories. (Note that some are covered by the standard set out in the directive, whereas others are defined only on a national basis.)

- structured funds
- funds of funds
- master and feeder funds
- alternative funds of funds
- index funds
- umbrella funds
- money-market funds

1 – Structured funds

The regulator was quick to react to the spectacular growth of structured (or "formula-based") funds in France. Given their prominence in the French market, the COB looked closely at their characteristics and, in late 2002, issued a decision statement setting forth regulatory and disclosure rules.

Structured funds are products that, at maturity, automatically deliver a return determined by a predefined set of market parameters (index values, price of a basket of stocks, etc.). They usually, but not always, provide a guarantee of principal at maturity (the case for more than 90% of them in 2003). On average, 14 new structured funds have been authorised every month for the past two years.

Real-time monitoring of this business segment will be facilitated by the overhaul of the AMF's fund database and implementation of the new classification system as of mid-2004. Already, though, the data show that guaranteed funds – the great majority of which are formula-based – accounted for nearly one-fifth of net inflows into French-law funds in 2003.

The treatment of these funds must be based on the following five points:

- Funds must be specifically named, notably via the new fund classification system, and must be regulated accordingly. This is what the amended Decree 89-623 has undertaken to do, notably via amendments addressing the use of derivatives.
- The fund management function must be properly organised, to ensure both that the product operates smoothly (e.g. with continuous valuation) and that management procedures are segregated from the trading rooms which devise the underlying structuring. This point, already mentioned in connection with programmes of operations, is essential for explaining to investors the precise responsibilities of the management company.
- A major effort is needed to ensure that all documents providing information about the fund, whether for regulatory purposes (notices, prospectus) or for marketing, are readable and balanced. Thus, providers are responsible for using formulae that are comprehensible to the target clientele and clearly stated in the notice, the prospectus and the marketing materials. On this point, fund managers must pay special attention to the drafting of the section on the economic characteristics of the product, which is essential to a proper understanding of the proposed formula. This section must not be limited to presenting the mathematical formula but must actually describe the economic bet the investor is being asked to make. Furthermore, because formulae vary so widely in duration and other characteristics, it is vital that all performance figures be stated as an annual yield to maturity, regardless of the medium used.
- The significance and cost of the principal guarantee must be explained to investors. As already noted, much of the success of structured funds is attributable to the fact that they guarantee the investor's capital. Firstly, as a rule, the guarantee applies only at maturity. Any mention of the guarantee must therefore be accompanied by a reminder that it does not take effect until the product matures, since the quid pro quo of the indexing mechanism is that the investment be held to term. Secondly, since investors do not always understand the potentially high costs of the guarantee, providers are asked to make them readily apparent, not only in the section of the prospectus on advantages and risks but also in marketing materials.
- Care must be taken to ensure that the product is marketed prudently and in a manner suited to the target clientele. Providers must of course be reminded of their obligation to give the prospective client a copy of the simplified prospectus prior to subscription, but this is not enough. Emphasis must be placed on:
 - o the know-the-customer rule (personal situation, aims, experience)
 - o the advice that the person responsible for marketing is able to give clients
 - o the internal organisation of providers that market funds to the public, in order to control the risk of mis-selling not just when the product is launched but throughout its life cycle.

2 –Funds investing in other funds

Since 1998, funds organised under French law have been allowed to invest all their assets in other French funds or foreign UCITS covered by the mutual recognition procedure established by

directive 85/611/EEC. While this provision has permitted the development of risk-profiled funds (which combine a predefined mix of fixed-income and equity exposures in a single vehicle) and multi-management funds (with multiple managers and strategies), this type of product can pose problems, especially when it entails both direct and indirect management. The problems arise from the multiple layers of management fees and from lack of transparency in investor disclosures.

Coinciding with the implementation of the proposals of the working group on management fees and the provisions of the new EU directive, major efforts have been made to shed light on these products, which now occupy a substantial position in the French market.

In 2003 funds with more than 50% of their assets invested in other funds (“funds of funds”) accounted for 18.4% of total products (1,338) and 9.2% of total assets under management (€74.7 billion).

Funds combining investments in other collective schemes (between 10% and 50%) and direct investment – with the aim, for example, of benefiting from the special skills of another management team in a particular asset class – numbered in excess of 2,500 and accounted for over €200 billion in assets.

Funds investing all or part of their assets in other funds

Situation at 31 December 2003	2002		2003		
<i>Assets under management in € billion</i>	Assets	% of total	Number	Assets	% of total
More than 10% invested in other funds	538.0	71.7%	3,394	562.8	66.7%
Between 10% and 50% invested in other funds	151.1	20.2%	2,532	206.1	24.4%
More than 50% invested in other funds	60.5	8.1%	1,338	74.7	8.9%
Total	749.6	100.0%	7,264	843.6	100.0%
<i>Source: AMF</i>					

3 – Master and feeder funds

At year-end 2003 there were 501 master funds with assets of €166.2 billion under management. They accounted for 18.3% of total assets of all general funds, compared with 16% in 2002. For the third consecutive years, the number of master funds was up sharply (19%), as was the value of assets under management (29%).

There were 642 feeder funds with €65.8 billion in assets, or 7.2% of the total, compared with 578 feeder funds and €53.5 billion in assets at year-end 2002. As in 2002, the number of feeder funds increased in 2003 (by 9%), as did the value of their assets (23%). Because all assets under management in feeder funds are included in the total assets of master funds, only the latter number is included in the aggregate assets of general funds, in order to avoid double-counting.

Because feeder funds seek to take advantage of a scale effect at the level of the master fund, they are used mainly in managing money-market assets (73% of the total). Under the Financial Security Act, funds organised under French law have been allowed since 1 April 2004 to have different categories of units. Going forward, providers can be expected to opt increasingly for this solution rather than for feeder funds.

At the same time, the new decree relaxes the rules on master-feeder funds by allowing the feeder fund to be structured so that the master fund is responsible solely for setting primary management policies.

4 – Alternative funds of funds

Long available in France, alternative funds of funds have developed significantly in recent years, in line with efforts made by the COB, in consultation with the industry, to clarify their regulatory status. This culminated in April 2003 with the publication of a statement of conclusions.

At the beginning of 2000 there were 42 alternative funds of funds with assets of approximately €1.6 billion. Today there are more than 150, with more than €9 billion under management.

In parallel with the regulatory framework for investment service providers, discussed in Section I of this chapter (cf. programmes of operations), the framework applicable to investment products must be completed within the newly established context of the Financial Security Act and the amended Decree 89-623 and in the light of the initial experience in applying the April 2003 statement of conclusions. Similarly, it will be necessary to adjust the guidelines adopted in 2003 to define eligibility criteria for the underlying funds, operating rules for liquidity and valuation, and rules governing investor access and fund marketing.

5 – Index funds

Index funds aim to replicate the performance of a particular index, specified in the prospectus.

At 31 December 2003:

- 29 index funds were traded on Euronext Paris, compared with 33 one year before. These exchange-traded funds held assets of €4.7 billion.
- 161 unlisted index funds had assets of €12.5 billion, compared with 144 and €9.8 billion one year before.

The new directive includes an explicit exception to the risk-spreading rules for index funds. Transposition of the directive provides the occasion to define or clarify:

- the eligibility criteria for indices
- the concepts of index funds and tracking error
- the information content of the prospectus
- the status of products that, while not strictly index funds, are managed in a similar way (“benchmarking” or “enhanced index” funds),
- the listing conditions for exchange-traded funds, no longer limited to index funds only.

6 – Umbrella funds

Umbrella funds assemble a number of subfunds with different investment policies under a single legal entity. The umbrella fund structure has been available in France since 1998, but, in contrast to other European countries, it has been used only marginally here.

At 31 December 2003 there were 30 umbrella funds with €6.6 billion under management. There were 130 subfunds, compared with 120 one year before. International equity subfunds accounted for 41% of the total number and 53% of the assets. European equity subfunds accounted for 13% by number and 23% by value.

The Financial Security Act has provided support for this type of product by establishing clearly that the subfunds of an umbrella fund are financially independent of each another.

7 – Money-market funds

The prominent place of money-market funds in France's investment management industry is often highlighted. Whereas French funds make up less than 20% of the total European fund market, French money-market funds account for 43% of assets held in European short-term funds (according to FEFSI figures).

The new EU directive made it possible to clarify a number of key questions in this area in the amended Decree 89-623, viz. the utilisation of negotiable debt instruments, and more generally, the eligibility criteria for unlisted money-market instruments, and the use of bank deposits and repurchase agreements.

It must also be noted that:

- Certain money-market funds that had been the subject of a cross-market review in first-half 2002, owing in particular to their use of asset swaps, were able to return without incident to fair valuation at 31 December 2003, thanks notably to favourable trends in markets and yield spreads.
- Work on the new prospectus provided the occasion to enhance investor information by distinguishing three types of fund:
 - o regular money-market funds, which, because of their investment policy constraints (rating, duration, etc.) and the instruments in which they invest, exhibit no volatility;
 - o money-market funds that seek to enhance performance by accepting some exposure to credit risk and therefore accept a degree of volatility;
 - o so-called "dynamic money-market funds" that add diversified exposure (e.g. to equities, alternative funds or convertible arbitrage) to a portfolio invested chiefly in money-market instruments. Funds of this type are normally classified as "diversified funds".

C – LIABILITY MANAGEMENT AND ORDER CENTRALISATION IN INVESTMENT FUNDS

News of market-timing and late-trading practices at US investment funds prompted the AMF in late 2003 to send requests for information to the top 40 equity fund managers in the French

market. The questions focused on the firms' valuation and liability management practices and on the measures taken to limit the risk of such practices in their funds. Together, the 40 companies accounted for two-thirds of all equity funds and 86% of the corresponding assets under management.

Market timing consists in placing trades to take advantage of small differences between a fund's net asset value (NAV), i.e. the price at which investors buy or sell, and its true market value. These arbitrages benefit the market-timer at the expense of the ordinary investor and thus reduce the fund's performance for unit-holders as a whole. A management company or affiliated firm that aids or abets such trades contravenes its obligation to act exclusively in the interest of unit-holders.

Late trading involves accepting subscription or redemption orders on an investment fund after the deadline specified in the prospectus for orders to be filled at that day's NAV. A late-trader can thus buy or sell fund units at an expired price, i.e. one that does not reflect events that occurred or information that became known after it was established. As with market timing, late trading detracts from fund's performance for the community of unit-holders. It is generally contrary to the provisions of the fund's prospectus on buying and selling units. Furthermore, as with market timing, a management company or affiliated firm that aids or abets late trading contravenes the rules of conduct that oblige it to act exclusively in the interest of unit-holders.

For French-law funds, the risk of such practices is in principle limited by the following factors:

- the custodian's role in, and responsibility for, monitoring trading in fund units;
- the rules that require management companies to put the interest of unit-holders first and ensure that all are treated equally;
- the efforts that management companies have been making since the early 1990s to match fund valuation rules to the terms and conditions of subscription and redemption;
- the nature of the arbitrage risk, which is greatest for funds invested in stocks traded on markets in a significantly different time zone. In the United States, this risk is amplified by the large size of equity funds, the proliferation of unregulated hedge funds, and the way in which the cut-off time rule is generally applied, which magnifies the impact of the time difference between the US and major Asian markets.

The management companies' responses to the AMF's questionnaire revealed no major shortcomings. The AMF has nevertheless decided to conduct further, targeted on-site and off-site audits to confirm this initial assessment.

In the broader context of fund liability management, prevention of arbitrage risk calls for the industry and the regulator to tighten and clarify the rules on selling, buying and valuing fund units in order to avert operational risks and conflicts of interest of all kinds. This can be achieved through standards for organisation of internal control, governance of the fund and segregation of functions. An industry-wide consultation and, if needed, subsequent rule changes will result in clearer requirements for the administration of funds' liabilities.

IV – Employee savings schemes

A – EMPLOYEE INVESTMENT SCHEMES

1 – Authorisations granted in 2003

In 2003 the COB, and then the AMF, authorised the creation of 272 new save-as-you-earn funds (FCPEs), compared with 312 in 2002, and the transformation of 2,073 existing FCPEs, compared with 948 in 2002.

During the year, 375 FCPEs were involved in mergers, compared with 171 in 2002. At 31 December 2003, the number of FCPEs stood at 3,352, compared with 3,600 one year before. A single open-end investment company for employee shareholders (SICAVAS) remained in active operation.

The number of mergers and transformations was particularly high in 2003 for several reasons: restructuring of product ranges, elimination of many smaller single-employer FCPE in favour of larger multi-employer funds, and continued updating of fund documents to reflect all the changes in implementing regulations that have emerged from the reforms initiated in 2001.

Of the 3,352 FCPEs on record, 2,553 are funds reserved for employees of a single company or group and 799 are multi-employer funds.

FCPE inflows and outflows, 1999-2003

	1999		2000		2001		2002		2003	
	€ million	%								
Special profit-sharing reserve	2,693	35.4	3,040	36.2	3,648	45.6	3,532	44.5	3,493	43.6
Employees' contributions and incentive payments	4,205	55.3	4,580	54.6	3,397	42.5	3,454	43.6	3,533	44.2
Additional contributions	707	9.3	775	9.2	956	11.9	944	11.9	978	12.2
Total contributions (gross)	7,605	100.0	8,395	100.0	8,001	100.0	7,930	100.0	8,004	100.0
Total redemptions	8,671	87.7	8,254	98.3	7,764	97.0	7,024	88.6	8,157	101.9
Subscriptions (net)	934		141		237		906		-153	

Source: AMF

The breakdown of assets under management shows a substantial increase in listed corporate securities (up €4.2 billion) and in investments in collective schemes (up €2.3 billion).

The increase in the value of listed corporate securities is attributable to rising markets rather than to net new business. Also visible is a continuing trend towards greater portfolio diversification, notably by reallocating assets into euro-denominated negotiable debt securities.

FCPE assets by type of financial instrument, 1999-2003

Net assets (€ billion)	1999	2000	2001	2002	2003
Employing company securities	24.2	28.6	26.6	22.0	26.5
- <i>listed shares</i>	<i>20.5</i>	<i>24.2</i>	<i>22.0</i>	<i>17.5</i>	<i>21.7</i>
- <i>unlisted shares</i>	<i>2.0</i>	<i>2.5</i>	<i>2.8</i>	<i>2.6</i>	<i>2.8</i>
- <i>bonds</i>	<i>1.7</i>	<i>1.8</i>	<i>1.8</i>	<i>1.9</i>	<i>2.0</i>
Collective schemes	9.4	10.9	10.0	12.5	14.8
Equities and similar	11.4	10.8	11.7	7.5	7.7
Fixed income products and cash	5.6	4.4	4.9	5.4	7.0
Net assets	50.54	54.78	53.19	47.43	56.02

Source: AMF