Chapter 4

Investment Services Providers, Investment Products and Market Infrastructures

The Autorité des Marchés Financiers (AMF) regulates and oversees investment services and financial investment advice. It lays down conduct of business rules for investment services providers (ISP) and financial investment advisers, and supervises compliance with these rules.

The AMF authorises investment management companies and approves the programmes of operations of other ISPs when they provide management services on behalf of third parties. The provision of other investment services requires authorisation from the committee for investment firms and credit institutions (Comité des Etablissements de Crédit et des Entreprises d'Investissement, CECEI), with the assent of the AMF. The list of investment services is established in Article L. 321-1 of the Financial and Monetary Code. It includes order reception/transmission for third parties, order execution for third parties, dealing for own account, asset management for third parties, underwriting and placement.

The AMF also establishes organisation and operating principles for market operators, securities settlement, central securities depositories and clearing houses.

The AMF authorises the creation of investment funds and other collective investment schemes. It supervises such products throughout their lifecycle and monitors the quality of their disclosures.

The challenge facing the AMF is to protect investors while fostering growth in the financial services industry. We continued to make large strides in the area of investment management regulation in 2005, driven by:

– implementation of the last set of projects arising from the Financial Security Act [1], such as creating a professional framework for financial investment advisers; improving the status of debt securitisation funds (FCCs), conditions for exercising the voting rights attached to shares held by collective investment schemes and the terms by which investment managers account for them, and the finalisation of the regime for funds authorised to operate under streamlined investment rules (ARIA funds);

– the transition to the new "simplified prospectus / full prospectus" format established by the UCITS Directive[2];

– continued work on the new real estate collective investment scheme, the OPCI;

– the review of the findings of three working groups set up to modernise rules on depositories compliance and the calculation of the commitment ratio[3] which had been rendered obsolete mainly by advances in financial management techniques.

The desire to assist industry professionals seeking clarification of existing regulations also led the AMF to publicise its positions more widely.

This ongoing adaptation of the regulatory framework reflects the dynamic nature of the French investment management industry, which once again grew strongly in 2005:

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[1] Act No. 2003-706 of 1 August 2003.

[2] Directive 85/611/CE amended.

[3] The commitment ratio makes it possible to limit the contribution of derivatives instruments and securities lending to the scheme's risk profile. It is defined in Article R. 2114-12 III of the Financial and Monetary Code.

– gross assets under management by collective investment scheme [4] came to €1,066 billion at 31 December 2005, an increase of 13.8%;

– the number of collective investment scheme dropped slightly, to 7,073 at 31 December 2005, although the number of new funds rose yet again to 816;

– the number of investment management companies remained virtually stable at 486 in 2005, but a large number of authorisations were granted, transformed or revoked, testifying to ongoing restructuring in the industry.

Table 1

	AMF DECISIONS	2005
Other investment services providers*	Approval of programmes of operations	2
	Refusal of proposed programmes of operations	N/A
	Notifications of programmes of operations, including:	36
	Custody account keeping	11
	Investment services other than management	25
	Use of European passport to conduct business in another state of the European Economic Area	
	Freedom of establishment	11
	Freedom to provide services	116
	Use of a European passport to conduct business in France	
	Freedom of establishment	8
	Freedom to provide services	132

* not including investment management companies.
Source: AMF

[4] Excluding feeder funds.

Table 2

	AMF DECISIONS	2000	2001	2002	2003	2004	2005
Asset management companies/ UCITS	Authorisations granted to asset management companies	62	59	36	33	68	37
	Asset management companies	58	56	33	30	68	37
	Fund management companies	4	3	3	3	0	0
	Use of European passport to conduct business in another state of the European Economic Area						
	Freedom of establishment					1	4
	Freedom to provide services					47	23
	Use of a European passport to conduct business in France						
	Freedom of establishment					0	0
	Freedom to provide services					15	11
	Funds authorised (total)	1,267	1,354	1,204	1,033	937	1,074
	Open-end investment companies (SICAVs)	112	44	27	28	13	19
	General-purpose unincorporated investment funds (FCPs)	843	967	826	697	689	797
	Venture capital funds (FCPRs)	54	35	37	34	51	41
	Employee investment schemes (FCPEs)	255	303	312	272	174	214
	Futures and options funds (FCIMTs)	3	5	2	2	10	3
	Funds declared via the simplified procedure	261	213	189	177	149	0
	Contractual funds declared	0	0	0	0	0	26
	Authorisations granted to transform a fund	2,104	1,797	2,586	3,792	6,745	7,700
	Authorisations granted to UCITS*	609	503 **	461	402	254	
Other	Visas issued for debt securitisation funds (FCCs) and subfunds	4	8	7	6	6	
	Visas issued for real estate investment trusts	14	12	10	45	31	37
	Opened to public	2	1	1	2	8	6
	Capital increases	4	-	0	0	10	11
	Change in price, updated prospectuses	8	11	9	43	13	20
	Visas issued for film production finance vehicles (Sofica)	8	9	6	10	18	29
	Newly established	5	6	4	10	11	12
	Capital increases	3	3	2	0	7	17***
	Visas issued for fishing industry finance vehicles (Sofipêche)	8	7	4	4	8	2
	Newly established	7	7	4	4	8	2
	Capital increases	1	-	0	0	0	0

Source: AMF
* or subfunds
** revised figures
*** including 14 additional authorisations

1 Changes in the Regulatory Framework

A Regulatory Changes in 2005

1 Investment Products

a) Collective Investment Schemes Excluded from the Scope of Offers of Securities to the Public

The Economic Modernisation and Confidence Act (no 2005-842, 26 July 2005) redefined the scope of offers of securities to the public and completely recast Article L. 411-2 of the Financial and Monetary Code. The new wording now expressly excludes collective investment schemes from the scope of offers of securities to the public [5], thereby corroborating the prior legal interpretation based on European directives.

This clarification led the AMF to confirm that:

– It is not necessary for open-ended investment companies (SICAVs) to publish a notice of shareholders' general meeting in the official gazette (BALO); however, pursuant to Article 124 of the ministerial order of 23 March 1967, they are still required to publish the notice of meeting in a newspaper authorised to receive legal announcements in the administrative area where their registered office is located;

– SICAVs must publish their notice of incorporation in a newspaper authorised to receive legal announcements in the administrative area where their registered office is located rather than in the BALO[6];

– The time period for a SICAV's creditors to oppose a merger now begins with the publication of the merger notice in a newspaper authorised to receive legal announcements in the administrative area where the SICAV's registered office is located rather than in the BALO[7];

– SICAVs are no longer required to produce a report on corporate governance, since the Act of 26 July 2005 now limits this requirement to companies offering securities to the public [8].

b) The Transition to a Prospectus for Collective Investment Schemes

1) Implementing the Procedures and Extending the Deadlines

The advice issued by the Committee of European Securities Regulators (CESR) on the transitional provisions for amending the UCITS Directive[9] held that UCITS I funds should have a simplified

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[5] Article L. 411-2 of the Financial and Monetary Code now stipulates that "The admission to trading on a regulated market, or the issuance or transfer of financial instruments, does not constitute a public offering if it is […] Issued by an organisation referred to in 1 of I of Article L. 214-1."

[6] Article 411-21 of the General Regulation and Article 10 of Instruction 2005-01 of 25 January 2005 dealing with the approval process for French and foreign schemes' periodic disclosures have been amended to reflect this change.

[7] The amendment to Article 411-21 of the AMF General Regulation to reflect this change was approved by the finance minister on 18 January 2006.

[8] The AMF issued recommendations on 25 May 2004 aimed at encouraging general-purpose unincorporated investment funds (FCPs) to make reference to the report produced by their investment management company, and encouraging asset management companies not incorporated as a *société anonyme* limited company to produce a similar report so that all investors have access to comparable information. As a result of the Economic Modernisation and Confidence Act of 26 July 2005, these recommendations are no longer applicable.

[9] Directive 85/611/CE amended

prospectus and a full prospectus by 30 September 2005 at the latest. To ensure a common standard for the information available to French investors, the AMF extended this requirement to all French-based collective investment schemes.

To organise the transition to the new prospectus for all collective investment schemes, the AMF worked with industry professionals to implement a specific approval procedure[10].

The procedure includes a number of aspects that permit:

– a phased, progressive transition to the full prospectus in order to ensure that investment management companies and the AMF regulator are not overwhelmed as the deadlines approach;

– investment management companies to implement an organisation and procedures that ensure that the timetable is respected and that prospectuses comply with current regulations;

- a procedure tailored to the needs of investment management companies and the nature of the products:

- companies required to produce large numbers of full prospectuses may, under certain conditions, prepare some of them under a declaration procedure, subject to post-publication review by the AMF;
- other investment management companies must produce full prospectuses under a pre-publication review procedure.

Exceptionally, for schemes limited to 20 investors at most or to a category of investors[11], the transition to the prospectus may be made via the declaration procedure subject to a post-publication review by the AMF. Owing to the combined efforts of the AMF and investment management companies, 54% of UCITS had made the transition to the new prospectus by 31 December 2005. The next deadline is set for 30 April 2006, by which date all other schemes[12] will have to provide a full prospectus.

2) Simplifying and Clarifying Disclosures

When examining the submissions made during the transitional phase, the AMF identified discrepancies between the spirit of the simplified prospectus and the way in which it had been implemented. The Authority therefore drew the attention of investment management companies to the principles underlying the new prospectus[13]. The discrepancies were mainly due to the fact that the wording used for the simplified prospectus was complex compared with that in the full prospectus. The simplified prospectus is intended to give basic information about the scheme. Its disclosures therefore must be clear and transparent so that investors can make fully informed decisions. When writing about funds offered to the public, companies should avoid technical language. When unavoidable, technical terms should be explained. The prospectus should include a brief, clear and attractive presentation of the scheme's main characteristics. The goal is to make the prospectus engaging and easy to read. It must not mislead investors, for example by omitting information they would need to make an informed decision.

[10] AMF monthly review, issue 9, December 2004.
[11] As defined by Article 411-12 of the AMF General Regulation.
[12] 2004 annual report
[13] News release dated 1 February 2005; available on the AMF website.

3 Introduction of the "Free Form" Simplified Prospectus

Instruction 2005-02, which deals with the full prospectuses prepared by collective investment schemes approved by the AMF, was amended in June to accommodate a new presentation: a simplified prospectus presented in an open format ("free form").

Under the article, schemes that are open to all investors, that implement a simple investment strategy with stable risk exposure, and that have a risk profile which is understandable to a non-sophisticated investor may prepare a simplified prospectus.

Schemes may choose any type of presentation they wish, provided they include all information mandatory in the simplified prospectus. Only one investment management company has so far taken up this option, even though it gives companies the potential to simplify they way they present information.

c) Collective Investment Schemes Now Allowed to Use a Prime Broker

Some alternative management strategies require the use of a prime broker, who enables collective investment schemes to implement their strategies and secure financing, notably by borrowing securities and cash against the fund's assets. The collateral arrangement consists of a lien on the assets or transfer of full ownership to the prime broker.

"Prime brokers" do not exist in French law, but the term refers to a company engaging in a range of regulated activities, including:

- brokerage and principal trading in derivatives

- clearing

- custody account keeping

For French-based schemes to be able to use prime brokers, it was first necessary to clarify a number of issues:

- the linkage between the functions of the depository, which is responsible for safekeeping the fund's assets and ensuring the legality of the investment manager's decisions, and those of the prime broker. The approach adopted favours a contractual definition of the respective responsibilities, without calling into question the depository's obligations under French law[14], particularly the following considerations:

  - where the depository and the prime broker are party to a custody mandate, there can be only one depository, which is responsible for safekeeping all the assets of a given scheme,
  - the depository is responsible for ensuring the legality of the investment manager's decisions and must therefore establish contractual arrangements for receiving information from the prime broker in order to exercise its oversight function;

- the conditions under which a scheme may grant guarantees. The framework governing the guarantees granted by a French scheme derives mainly from the provisions enacted when the Collateral Directive (2002/47/EC) was transposed into French law;[15] it also includes provisions specifically related to the valuation of both the prime brokers' claim on the scheme and the collateralised assets[16].

[14] Financial and Monetary Code, Articles L. 214-16 and L. 214-26
[15] Articles L. 413-7-1 *et seq.* of the Financial and Monetary Code.
[16] Articles R. 241-12, I of the Financial and Monetary Code and Articles 411-33-1 and 411-33-2 of the AMF General Regulation.

In practice, investment management companies and depositories wishing to set up a collective investment scheme that will employ a prime broker must first present the planned organisational structure to the AMF. They may refer to AMF Instructions 2005-01 (authorised schemes) and 2005-03 (contractual schemes) dealing with the specific documents that must be supplied as part of an approval request[17] or declaration[18] by the scheme in question.

The French framework for alternative management, established at the request of and in collaboration with industry professionals, was finalised on 1 September 2005. As a result, complex management techniques can be used with an onshore scheme. Four AMF-approved schemes were using prime brokers at 31 December 2005.

d) Rebates in Funds of Funds

When the COB's regulations were amended in late 2003 to implement the finding of a report on fees and commissions payable by investors in collective investment schemes,[19] a general principle was adopted whereby rebates of management fees or subscription and redemption commissions related to a parent fund's investment in a target fund should benefit the parent fund only. This principle, which went into effect on 1 January 2005, thus forbids rebates from accruing to the parent fund's investment management company or to a third party.

The AMF published an article[20] drawing attention to the conditions for implementing this regulation and to the implementation timetable. The article also sought to clarify which arrangements could be used by investment management companies.

During 2005, the AMF amended its General Regulation[21] to:

- expand the prohibition of rebates to all schemes distributed in France while expressly exempting schemes and investment funds managed by French investment management companies but distributed outside the country. Article 411-53-1 of the AMF General Regulation applies to any schemes distributed on French territory. The only French schemes that are exempt from this regulation are those distributed solely outside of that territory. For purposes of consistency, all schemes distributed on French territory must comply with this article. Consequently, authorisation to distribute a foreign schemes on French territory is subject to confirmation by the schemes' managers that this article is respected;

- specify that the distributor of a target fund may receive rebates in respect of the parent fund's investment in the target fund if the distributor is acting independently of the investment management company. This clarification is intended to enable companies managing target funds to use distribution platforms to distribute their funds and compensate those platforms through rebated management fees or subscription and redemption commissions.

e) Expanding the Scope of Exchange-Traded Funds

Until recently, only index funds, i.e. collective investment schemes that seek to replicate the performance of a particular index as closely as possible, could be admitted to trading on a regulated market.

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[17] Schedule I-1 and I-2 of AMF Instruction 2005-01: name of the prime broker or brokers, prime brokerage agreement, custody delegation agreement, prime broker engagement letter complying with the standard format in Schedule 1-5 of the instruction.
[18] Schedule I and II of AMF Instruction 2005-03: name of the prime broker or brokers, prime brokerage agreement.
[19] Report of the working group headed by Philippe Adhémar, published 9 October 2002, dealing with fees and commissions paid by the investor in a collective investment scheme.
[20] AMF monthly review, issue 9, December 2004. Article entitled "Rebates of subscription and redemption fees and management fees in funds of funds: practical methods for allocating these rebates to funds of funds and subscriber disclosure requirements".
[21] Article 322-44 of the General Regulation and AMF monthly review, issue, 14, May 2005.

In response to demands from industry professionals, and in light of Euronext's desire to develop this market segment, the AMF's General Regulation was amended to expand the scope of exchange-traded funds (ETF) to include schemes with a more active objective.

The concept of a collective investment scheme "whose management objective is based on an index" was introduced, along with specific rules on matters such as disclosure.

These schemes still offer exposure that is linked to an index's performance, but the exposure is calculated using a preset formula that allows an investor to "arbitrage" the product.

This change was made by adding two articles, 411-56-1 and 411-56-2, to the AMF General Regulation.

Two ETFs were admitted to trading on a regulated market under this framework in 2005. One uses the dynamic portfolio insurance technique linked to the performance of an index. The other provides leverage that varies according to the movements of the same index.

Alongside these changes, all the provisions relating to ETFs, previously found in Book II of the General Regulation, were moved to Book IV so that an ETF would be subject to a single approval by the AMF based on its full prospectus (before this, it also had to submit a listing prospectus for AMF approval). At the same time, CESR has worked to clarify the definition of the assets that can be held by collective investment schemes[22].

f) Debt Securitisation Funds and their Investment Management Companies

1) Amending the Organisation of Investment Management Companies Involved in Active Management

The AMF overhauled the section of its General Regulation applicable to management companies of debt securitisation funds (FCCs), bringing it into line with the new provisions of the Financial Security Act and its implementing order (2004-1255, 24 November 2004).

The main changes deal with:

- the possibility for FCCs to issue debt securities;

- the creation of a special allocation account intended to shield the fund's assets from the risk of failure of one of its transferors;

- the possibility for a fund to use derivative financial instruments, notably credit derivatives, as part of its investment strategy;

- the possibility of actively managing the FCC's assets.

The General Regulation was amended[23] to create an operating framework for FCC managers that use derivatives or actively manage their assets. These amendments deal in particular with the organisation, resources and conditions for delegating management.

The "one-third" rule[24] was eliminated to make it easier for new shareholders to invest unrestrictedly in fund management companies; accordingly, a single shareholder can now own an FCC

[22] See Chapter 2 on CESR IM.

[23] Articles 331-1 *et seq.* of the AMF General Regulation, amended 1 September 2005

[24] The "one-third" rule was designed to prevent the risk of conflicts of interest between the transferor and the investment management company. The shareholder of an investment management company was not allowed to hold more than one-third of

management company. At the same time, conduct of business rules based closely on those applicable to asset management companies were introduced.

The AMF General Regulation stipulates two possible organisational structures for FCC management companies:

- companies that deal in derivative financial instruments for passive management purposes. In this case, the management company must equip itself to identify financial risks and manage associated legal risks;

- companies that actively manage their assets using both physicals and derivatives. In this case, the management company must, in addition to the above obligations, equip itself to implement its management strategies as planned, to independently evaluate financial risks and to oversee the commitments of its funds at all times.

These last obligations are based on those applicable to asset management companies implementing an approved programme of operations for credit derivatives.

The financial management of FCCs using derivatives or actively managing their assets may be delegated either to an asset management company whose programme of operations has been specifically approved for the use of credit derivatives, or to a credit institution approved in France as an asset manager, or to a French-based branch of a credit institution with its registered office in a European Economic Area member state.

Management may also be delegated to any credit institution whose registered office is located in an OECD member state, to any investment firm in the European Economic Area, or to any individual licensed as an asset manager or a collective investment scheme manager, provided they are authorised to engage in those activities.

However, if a management company does not have the organisational resources that enable it to handle the financial management of FCCs, it must create a mechanism for overseeing the entity to which it has delegated that task.

Regarding the prevention of money laundering and terrorist financing, the General Regulation adapted the rules applicable to asset management companies to address the specific characteristics of FCC managers.

2) Transposition of the Prospectus Directive

FCCs are subject to the provisions of the Prospectus Directive[25].

As a result of the new rules applicable to FCCs[26], the regulations governing transactions by these funds are the same as for any issuer offering securities to the public. However, certain FCC-specific rules have been maintained.

Hence:

- the content of fund prospectuses must now be consistent with the schedules in Regulation (EC) 909/2004 of 29 April 2004. The COB instruction of May 2003 on FCCs is no longer applicable;

- the prospectus must include a summary;

- the approval period has been reduced to 20 days for a first offer of securities to the public;

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the investment management company's capital if it was a transferor to a debt securitisation fund managed by said investment management company.

[25] Directive 2003/71/EC.

[26] The regulations applicable to debt securitisation funds are found in Title II, Chapter I of Book IV of the AMF General Regulation.

- the AMF is no longer able to include a warning when it approves a prospectus. However, promotional materials must include a statement calling readers' attention to the "risk factors" section of the prospectus, and, if applicable and at the request of the AMF, to the unique characteristics of the issuer, any guarantors and the financial instruments involved in the offering;

- the investment management company must now provide the AMF with a document containing or referring to all the information they have published or made available to the public over the preceding 12 months.

2 Investment Services Providers (ISPs)

a) Investment Research

Building on the transposition of Directive 2003/125/EC implementing the Market Abuse framework directive, some technical adjustments were made to the provisions dealing with investment research. Some issues that were originally to be clarified in an AMF instruction were, in the end, written into the General Regulation and received ministerial approval on 8 September 2005.

This is notably the case with the territorial scope of transparency rules. When a French ISP locates its research supervision function outside France, it must adopt a procedure establishing how this function will be performed, although it is not required to issue a professional licence[27]. A new chapter[28] specifies that all the provisions dealing with investment research apply equally to research disseminated from abroad if it relates to financial instrument issuers making offers of securities to the public in France and is distributed to investors residing or based in France.

Other changes were made to clarify the rules governing the publication and accessibility of research[29]. This has made it possible, among other things, to eliminate the ambiguity related to conflicts of interest that may arise between a company's production of investment research and its underwriting, placing and advisory activities[30].

b) Investment Management Companies' Voting Policies

In accordance with Article L. 533-4 of the Financial and Monetary Code, one of the conduct of business rules applicable to investment management companies requires them to exercise the voting rights attached to the shares held by their schemes solely in the interest of their unitholders or shareholders. These companies are also required to explain their voting policies in the manner specified in the AMF General Regulation.

The rules governing how companies publicise information regarding the exercise of their voting rights are laid out in Article 322-75 *et seq.* of the AMF General Regulation. They focus on three documents: a "voting policy" statement, a detailed explanation of the terms and conditions under which the company intends to exercise its voting rights, and an annual report reviewing how the company exercised its voting rights over the previous year.

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[27] Article 321-123 of the AMF General Regulation.
[28] Chapter VIII: distribution of investment research from abroad, Article 338-1.
[29] Articles 321-123 and 321-135 of the AMF General Regulation.
[30] 5) of Article 321-131 of the AMF General Regulation.

1) "Voting Policy" Statement

Investment management companies were required to draw up this document by 31 March 2005 at the latest. It can be made available at the company's registered office or posted on its website.

2) Detailed Explanation of the Terms and Conditions Under Which the Company Intends to Exercise its Voting Rights

The AMF clarified its regulations to streamline the procedures used by management companies to report on how they voted on resolutions. The emphasis has been placed on providing the information that investors needed to assess the way the voting policy is implemented. Provided the company votes in accordance with the principles set forth in its policy statement, they are not required to respond to investors' requests for information.

3 Annual Report on the Exercise of Voting Rights

This report specifies the number of companies for which the investment manager has exercised the voting rights attaching to the shares held by its schemes, expressed as a ratio of the total number in which it had voting rights. This ratio is useful because it enables investors to assess the degree to which the investment manager has adhered to the principles in its voting policy statement by attending the shareholders' general meetings of the issuers of securities it holds. The investment management company may also calculate an easier ratio, where the denominator is limited to the number of companies in which it has declared its intention to exercise its voting rights.

c) Investment Services Providers Other Than Asset Management Companies

1) Asset Segregation[31]

The provisions related to custody account keeping and the terms and conditions governing segregation changed significantly in 2005. All custody account keepers must have at least two accounts on the books of the central securities depository to keep their own assets segregated from those of their customers. This obligation also required any custody account keeper acting as agent for another custody account keeper to have two accounts per principal (one for the assets of the principal and one for the assets of the principal's customers). The rule requiring custody account keepers acting as agents to have dual accounts has been rescinded.

2) Prohibition Against Custody Account Keepers Allowing Debit Balances on Securities Accounts

Under previous regulations, a securities account was not allowed to go into a debit balance. However, if such a situation did occur, the custody account keeper was required to remedy it as quickly as possible.

The General Regulation now totally prohibits client accounts from being in debit at the securities settlement date. It also requires custody account keepers to establish procedures that prevent debit

31 These provisions are set out in Articles 332-18 and 332-39 (ministerial approval order of 1 September 2005) of the AMF General Regulation.

balances by alerting them to any trade or transfer capable of producing such a situation. The agent of a custody account keeper must verify that its principal(s) properly apply these procedures. If the agent observes that the procedures have not been implemented, it is not allowed to proceed with securities settlement. However, if technical factors prevent the agent from halting settlement, it must ensure that none of the financial instruments belonging to clients will be used for this purpose without their express consent. (The aim of this rule is to prevent custody account keepers from using clients' securities for their own settlement purposes; it is necessary because the dual-account rule has been scrapped.)

3) Terms and Conditions for Implementing Disclosure Requirements Related to Dealings in Financial Instruments

The main aim of Instruction 2005-08 of 6 September 2005, which established the rules under which financial intermediaries report transactions to the AMF, was to encourage the use of RDT, a data transmission system that was optional prior to 1 October 2005.

RDT must now be used by:

- ISPs that trade debt securities off the regulated market;
- custody account keepers that participate in order processing by offering reception-transmission services.

In addition, ISPs, regardless of whether they belong to a French regulated market, that execute over-the-counter trades in equity securities admitted to trading on that market are required to report their trades to the AMF through the market operator, using the operator's technical procedures. For example, for equity securities admitted to trading on Euronext Paris, ISPs report their transactions using the TCS trade confirmation system.

Lastly, for ISPs that are members of a French regulated market, the market operator continues to report its members' trades to the AMF where these are deemed to have been carried out on-exchange.

4) Instructions 2005-09 and 2005-10

Two instructions issued in 2005 incorporated decisions made by the CMF prior to the AMF's creation. The first is Instruction 2005-09 of 1 December 2005 dealing with asset management declarations in the context of a mandate; the second, Instruction 2005-10 of 1 December 2005, deals with administration mandates for financial instruments held in registered form.

d) Financial Investment Advisers (FIAs)[32]

The AMF expanded its General Regulation to include provisions on the status of financial investment advisers (FIAs) and the conditions for approving their professional associations. The new rules were submitted for public consultation in late 2004 and received ministerial approval on 15 April 2005.

The General Regulation stipulates:

- the conditions that must be met for certification as an FIA[33];

[32] 2004 AMF Annual Report. See also Chapter 4

[33] Articles 335-1 and 335-2 of the AMF General Regulation.

- the conduct of business rules applicable to FIAs,[34] which are required to:

  - disclose to customers their status as FIAs or direct marketers of banking or financial products, and any ties they may have to entities that promote financial products[35],
  - define their scope of action in a mission statement, produced in duplicate and signed by both parties[36],
  - produce a formal written document setting out their investment advice, the advantages it offers and the risk it entails[37],
  - maintain confidentiality with respect to customers and create an internal organisation structure that enables them to meet their obligations[38];

- the rules applicable to professional organisations[39]. In this respect, the General Regulation stipulates[40]:

  - the requirements for certifying their professional associations, in terms of registered offices, company purpose, legal representatives, human and technical resources, the creation of conduct of business rules applicable to FIA members, and the ongoing professional development of its members.
  - the approval process initiated by filing an application[41],
  - the association's disclosure requirements vis-à-vis the AMF,
  - the instances in which the AMF may decide to revoke the professional association's approval.

3 Markets

a) Rules Governing the Transfer of Ownership of Financial Instruments

Order 2005-303 of 31 March 2005 overhauled the rules governing the ownership transfer date for financial instruments that are admitted to the operations of a central securities depository or processed through a securities settlement system.

Previously, once a trade order had been executed on a French regulated market, the date on which the financial instruments were registered on the buyer's account, thereby transferring legal ownership, was the trade date. In international practice, however, it is more common for ownership transfer to coincide with securities settlement. In the interests of harmonisation, the French legislature decided, after consulting industry professionals, to bring French law into line with international practice. The AMF General Regulation[42] stipulates that, pursuant to the provisions of Order 2005-303 of 31 March 2005[43], securities will now be registered on the buyer's account, and thus ownership will now be transferred, on the securities settlement date. Except in exceptional

[34] Articles 335-3 to 335-10 of the AMF General Regulation.
[35] Article 335-3 of the AMF General Regulation.
[36] This mission statement must contain the information listed in Article 335-4 of the General Regulation.
[37] Article 335-5 of the AMF General Regulation.
[38] Articles 335-7 to 335-10 of the AMF General Regulation.
[39] See below.
[40] Articles 335-11 to 335-25 of the AMF General Regulation.
[41] Its content is detailed in Article 335-18 of the AMF General Regulation.
[42] These provisions are listed in Book V of the AMF General Regulation in the newly added Title VI entitled "Transfer of ownership of financial instruments that are admitted to the operations of a central depository or processed through a securities settlement system" in Articles 560-1 to 560-9.
[43] Order 2005-303 of 31 March 2005 dealing with the simplification of rules for the transfer of ownership of financial instruments that are admitted to the operations of a central depository or processed through a securities settlement system, ratified by Act 2005-811 of 20 July 2005 contains a variety of provisions transposing EC law governing financial markets. It notably stipulates that the transfer of ownership of a financial instrument from the registration of the instrument on the buyer's account on the date and under the conditions defined by the AMF General Regulation.

circumstances laid out in the General Regulation, this will take place three days after the trade date[44].

b) The Charter for Cooperation among Supervisory Authorities for Groups Operating Across Financial Sectors

To facilitate implementation of the Financial Conglomerates Directive, the French financial sector's supervisory authorities – the Autorité de Contrôle des Assurances et des Mutuelles (ACAM, the insurance supervisory authority)[45], the Commission Bancaire (banking commission), the Comité des Entreprises d'Assurance (CEA, the insurance industry committee), the Comité des Établissements de Crédit et des Entreprises d'Investissement (CECEI, the committee on credit institutions and investment firms) and the AMF – have drawn up a joint charter designed to strengthen cooperation between them when supervising groups operating across financial sectors, i.e. simultaneously in insurance, banking and investment services.
The charter organises consultations among authorities in the following cases:

- Regarding an approval or an equity stake involving a cross-sector group, the authority responsible for approving the transaction must consult the supervisory authority from the other sector, which has ongoing responsibility for oversight and thus possesses relevant information on group companies under its jurisdiction. The consulted authority must provide the approving authority in its sector with the information exchanged;

- When required to issue an opinion on the skill, fitness and properness of managers carrying out duties for companies operating in two sectors, the competent authorities confer together and then inform the supervisory authorities of the information exchanged.

This charter took effect on 21 October 2005[46].

B Regulatory Developments Initiated in 2005

1 Investment Products

a) Real Estate Collective Investment Schemes (OPCI)

Order 2005-1278 of 13 October 2005 implemented Article 50 of Act 2005-842 of 26 July 2005 creating the real estate collective investment scheme, or OPCI.

The OPCI rounds out and modernises the range of real estate investment products available to individual and institutional investors, the others being real estate investment trusts (SCPI) and listed property companies (SIIC). The OPCI will take one of two forms: a fund (*fonds de placement immobilier*, FPI) or an open-ended investment company (*société de placement à prépondérance immobilière à capital variable*, SPICAV). The two forms will be distinguished, inter alia, by their tax treatment. Income from an FPI will be treated as real estate income, while income from a SPICAV will be considered as investment income.

The OPCI offers greater management flexibility than an SCPI, notably the ability to invest as little as 60% of its assets in real estate, either directly or through shares in companies whose assets are

[44] These new provisions (ministerial approval granted 30 December 2005 and published in the Official Journal on 18 January 2006) took effect on 1 April 2006.
[45] The CCAMIP became the ACAM following the adoption of Act 2005 -1564 of 15 December 2005.
[46] The news release, dated 22 December 2005, is available on the AMF website.

composed mainly of real estate. This means that the new scheme can invest up to 40% of its assets in financial instruments and deposits.

The OPCI may also borrow up to 50% of the value of its real estate assets and use derivatives, and thus be leveraged.

In addition, unlike SCPIs, OPCIs will be required to redeem their units or shares at a net asset value which, for the real estate portion, will be calculated using the valuations established by two real estate appraisers.

Furthermore, 10% of non-real estate assets must be exposed to little or no risk in order to be able to meet redemption requests from unitholders or shareholders.

To enable the OPCI to function property and operate transparently, the regulatory framework will need to be expanded to include fundamental aspects such as governance, investor disclosures, real estate appraisal guidelines and, in particular, liquidity for investors.

On this point, the frequency and method for establishing the net asset value of the OPCI must be defined. It is also vital to determine the conditions in which the OPCI accommodates requests for redemption when, for example, unfavourable market conditions adversely affect liquidity.

The Order also prohibits the creation of new SCPIs and new capital increases from 31 December 2009, and requires that SCPI unitholders be offered the possibility to switch to OPCIs.

The Order has been or will be supplemented by the publication of:

- the 2005 Additional Budget Act[47], a ministerial order and a tax instruction in order to implement an ad hoc tax regime under which the OPCI would take the form of a fund or an open-ended investment company;

- a decree from the State Council giving details of asset eligibility, management constraints (inter alia, risk-spreading and debt), the responsibilities of the OPCI's statutory auditor, and the content of the management report;

- new provisions in the AMF General Regulation stipulating, inter alia, the conditions governing scheme participants (investment management company, depository, fund governance staff, appraisers), rules on subscription/redemption of units or shares, the type of information given to OPCI unitholders or shareholders, and the way it will be disclosed.

The regulatory framework will take effect once the changes to the AMF General Regulation have been published.

b) Rules for Measuring the Derivative Commitments of Collective Investment Schemes

The legislation setting the rules for measuring the derivative commitments of collective investment schemes had to be revised in light of financial market innovations, an amended definition of commitments in Article R. 214-12 III of the Financial and Monetary Code, and an EU recommendation published on the 27 April 2004 on the use of derivative financial instruments by UCITS.

The commitment ratio is one of the regulatory ratios that schemes must respect at all times. It is used to mitigate the contribution made by derivatives and securities lending to the scheme's risk

[47] Act 2005-1720 of 30 December 2005.

profile. It is therefore a relative, not an absolute, approach. The key issue is to gauge the impact of derivative financial instruments on the risk profile. The commitment ratio is part of a broader regulatory mechanism combining rules and investment ratios for the oversight of collective investment schemes.

The legislative revision was sought and supported by the industry and was carried out in collaboration with its representatives. This made it possible to craft a pragmatic framework and avoid introducing ambiguities with respect to the responsibilities of the regulator and investment management companies.

The draft versions of the AMF General Regulation and the instruction adopted by the Board were submitted for public consultation during the second quarter of 2005[48]. The texts were published on 21 March 2006 and will take effect on 1 January 2007.

The changes substantially alter the regulator's previous approach:

- they improve the consistency of the existing method, the so-called linear method, while introducing a degree of much-needed flexibility;

- they introduce a new method, called the "probabilistic" method, for schemes using complex derivatives or employing a management strategy with a particular risk profile, such as arbitrage strategies;

- they hold investment management companies accountable by requiring them to determine whether the risk profile of a scheme enables them to use the linear method or if they need to use the probabilistic method.

In implementing these changes, investment management companies will need to pay particular attention to understanding and managing the risks inherent in the strategies adopted by their schemes. They will also have to identify as early on as possible the schemes that will be the most affected by the new provisions.

2 Investment Services Providers (ISPs)

a) Compliance and Internal Control

In 2005, the AMF reformed the provisions of its General Regulation dealing with the organisation of compliance and internal control at ISPs, in order to harmonise the rules it had inherited from the legacy regulations. It also sought to harmonise the provisions of the General Regulation with Regulation 97-02 of the Banking and Financial Regulatory Committee on internal control in credit institutions and investment firms[49].

The draft amendment to the General Regulation was based on the recommendations of a working group composed of representatives from the investment services sector. It was put out for public consultation in summer 2005[50] and received ministerial approval on 9 March 2006.

The text adopted by the AMF:

- defines the concept of compliance, which encompasses two sets of responsibilities: firstly advising and informing employees, exercising regulatory oversight, and giving an opinion on new products and services before they are released; and secondly overseeing compliance;

[48] Posted on the AMF's website on 6 April 2004, under the heading "Consultations".
[49] Amended by Ministry of the Economy, Finance and Industry Order of 31 March 2005.
[50] Posted on the AMF's website on 2 August 2005 under the heading "Consultations".

- creates the position of Head of Internal Control and Compliance for asset management companies, thereby combining two previously separate functions. For other ISPs, the two functions of compliance and investment services control have also been combined as a single Head of Investment Services Compliance;

- creates professional licenses for the positions of Head of Internal Control and Compliance and Head of Investment Services Compliance investment services control , to be granted by the AMF following an examination[51].

The text also lays down rules for outsourcing and exercising this function, specifies the assignments of the Head of Internal Control and Compliance and the Head of Investment Services Compliance, and defines the components of asset management companies' internal control mechanisms.

b) Depositories

Under the Financial and Monetary Code, the assets of SICAVs and investment funds must be held by a depository, which is also responsible for ensuring the legality of the management company's decisions[52]. It is left to the AMF General Regulation to define the conditions for acting as a depository for other collective investment schemes (CISs)[53].

Three other factors make that definition necessary:

- CISs are using increasingly sophisticated investment techniques, thus broadening the depository's scope of action to include new types of assets (complex swaps, deposits with institutions other than CIS depositories, etc.). The depository does not hold these assets in a custody account[54], so it is necessary to establish the conditions for their safekeeping and control;

- The AMF has observed considerable disparities in account keeping practices and in the way that depositories carry out their duties;

- The development of open architecture raises procedural questions about liability accounting for CISs.

For this reason, the AMF formed a working group composed of the main industry groups, depositories and asset managers, instructing it to present the Board with proposals for a draft regulatory framework that took these factors into consideration. These proposals will be put out to public consultation during 2006.

C AMF Positions

The AMF continued its policy of disseminating its positions in 2005, publishing several position papers responding to industry professionals' requests for clearer interpretations of existing regulations.

[51] Previously, only the position of RCSI was granted a professional licence.
[52] Articles L. 214-16 and L. 214-26 of the Financial and Monetary Code. See also Chapter 4
[53] Article L. 621-7 V, point 4° of the Financial and Monetary Code.
[54] Within the meaning of Article 312-6 of the AMF General Regulation.

1 Requirements for Investment Management Companies to Become Members of Regulated Market

The AMF authorised an asset management company in summer 2005 to apply for membership of a regulated derivatives market in order to manage its portfolios[55]. The Authority considered that execution on a regulated market of orders stemming solely from investment decisions made by asset management companies could qualify as a special type of management activity. For this reason, that activity is open only to management companies whose business is confined to managing assets for third parties; it is not open to management companies that also perform an order reception and transmission function.

To acquire this status, the company must first obtain AMF approval of an updated programme of operations, covering among other things the applicant's resources and internal control system. When assessing the application, the AMF will also consider whether the direct access solution is in the economic interests of the applicant's clients.

2 The Possibility for a CiS to Enter into Contracts that Constitute Commodity Index Derivatives

The European Commission asked CESR for its advice on commodity futures indices, with particular reference to UCITS assets[56]. In light of CESR's work and two public consultations, the AMF observed a consensus among Member States to allow these indices to be eligible for ownership by UCITS; it also noted that the French investment management industry had shown keen interest in using them.

As a result, the AMF ruled[57] that, starting 1 December 2005, collective investment schemes (UCITS and non-UCITS) could enter into contracts constituting financial derivatives on an underlying commodity index. This will allow companies to create "commodity" index schemes and allow other schemes to gain exposure to commodity risk via derivatives.

3 FAQs and Decision Statements

The AMF continued to disseminate its operating doctrine in 2005 by publishing several Frequently Asked Question lists (FAQ) and statements of decisions. These publications are intended to outline the criteria used by the AMF to assess the proposals submitted by investment managers, thus making it easier for those companies to prepare their applications and for AMF staff to evaluate them. The documents are also designed to inform readers of the AMF's analysis of new topics or topics that have raised recurring questions.

To this end, the AMF published the following materials in its Monthly Review and on its website:

- An article defining best practices for venture capital funds[58] when drawing up prospectuses. The aim of the article was to help investment management companies put together applications for approval of these products. Among other things, it underlined the content requirements for certain

[55] AMF monthly review, issue, 17, September 2005.
[56] This request was intended to clarify the definition of eligible assets for UCITS given in the UCITS Directive (2001/108/EC). See Chapter 2
[57] News release of 1 December 2005 presenting the AMF Board's decision.
[58] AMF monthly review, issue, 15 June 2005.

sections of the offering circular and updated the AMF's warning, which is obligatory for all innovation fund prospectuses;

- An FAQ on employee investment schemes invested in unlisted securities[59]. This document clarified some practical aspects of the liquidity mechanism required of these funds. It also gave practical advice on pricing securities traded on non-European markets;

- An article on variable management fees with deferred equalisation share [60]. The article gave an example of how the methods generally used in foreign hedge funds to pay variable compensation to investment managers could be adapted to the French regulatory framework. This information enabled the investment management companies concerned to understand the way in which this type of arrangement would be feasible in the French regulatory context. It also provided an operating format that complied with French regulations, together with a list of the AMF's expectations in the event that these companies were to offer an alternative operating format;

- An FAQ dealing with variable management fees in collective investment schemes,[61] clarifying Article 322-40 of the AMF General Regulation. The main items covered were the threshold above which variable management fees are permitted, the percentage of outperformance on which fees are levied, and the conditions for informing investors;

- An FAQ on the operating rules for contractual funds [62]. The creation of the first few funds raised recurring questions about the management rules for these products, the terms and conditions for using alternative investment strategies, and coordination among the programmes of operations approved by the AMF. The goal of the article was to bring the AMF's answers to these questions to the attention of investment management companies;

- A statement of decisions relating to leveraged employee investment schemes[63]. This article reminded readers that the involvement of the participants in the leveraged transaction (investment management company, swap counterparty) must respect prevailing legislative and regulatory provisions, and that the issuer must make these transactions public. It also clarified the conditions under which a transaction can be challenged if the swap counterparty has difficulty hedging its positions.

59 AMF monthly review, issue, 16 July-August 2005.
60 AMF monthly review, issue, 16 July-August 2005.
61 AMF monthly review, issue, 17 September 2005.
62 AMF monthly review, issue, 18 October 2005.
63 AMF monthly review, issue 18 October 2005.