

# CHAPTER 2

## Investment services providers, investment products and market infrastructures

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**The AMF authorises, regulates and supervises investment management companies. It also participates in the authorisation, regulation and supervision of other investment services providers (ISPs) and market infrastructures, including market operators, clearing houses, central depositories and securities settlement systems. The AMF regulates and supervises financial investment advisers (FIAs) through their professional associations. It authorises and monitors collective investment schemes (CIS) and other collective investment products. It also supervises the marketing of such products, in particular by verifying the quality of disseminated information.**

**In performing its duties, the AMF must protect investors and while enabling the financial services industry to innovate and develop in an increasingly international and competitive market.**

In 2009 the AMF was once again heavily engaged in international regulation and cooperation in the field of asset management, as it sought to learn the regulatory lessons of the crisis, while actively pursuing its work on investor protection.

The AMF chairs the standing committee on investment management (SC5) of the International Organization of Securities Commissions (IOSCO). In 2009 SC5 published the findings of work begun in 2007 and 2008 on issues that were exposed or exacerbated by the crisis, including questions of valuation and due diligence by managers invested in structured products, due diligence by fund-of-hedge-fund managers, and prevention and management of conflicts of interest by venture capital firms. The committee also continued to work on topical issues, such as the key information to be provided to retail investors before investment funds are marketed or at the point of sale, suspensions of investment fund subscriptions and redemptions, and protection and segregation of client assets.

Within Europe, the AMF played an active role in negotiations surrounding the proposal for a new directive on alternative investment fund managers (AIFM), which seeks to ensure efficient supervision of the systemic risks potentially posed by these funds and enhance investor protection.

Furthermore, the AMF pursued and stepped up its involvement in the work of the Committee of European Securities Regulators (CESR). In February 2009 the European Commission asked CESR to propose technical implementing measures for the UCITS IV Directive in a number of areas:

- > the management company passport;
- > the Key Information Document;
- > fund mergers;
- > master-feeder structures;
- > the new notification procedure.

The AMF was actively involved in drafting CESR's advice in these areas, which was submitted to the European Commission at the end of 2009, notably by co-chairing the technical group on the Key Information Document. CESR also prepared a response to the European Commission's consultation on UCITS depositories through a working group chaired by the AMF and proposed a harmonised European definition for money market funds, which was presented in a consultation paper at the end of the year.

At home, the AMF continued to disseminate its positions – pursuing a process begun in 2008 – and stepped up monitoring of anomalies detected in funds, particularly at the marketing stage.

As market conditions improved, 2009 was a year of restructuring for participants and products.

Against this backdrop, the French fund management industry recorded the following performances in 2009:

- > gross assets under management stood at €1,388.3 billion at 31 December 2009, compared with €1,246.4 billion at 31 December 2008;
- > the number of collective investment schemes fell from 12,293 at end-December 2008 to 12,200 at end-December 2009;

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> the number of new collective investment schemes fell to 1,042 in 2009 from 1,454<sup>1</sup> in 2008;

> the number of investment management companies fell from 571 at 31 December 2008 to 567 at 31 December 2009. The number of new companies declined, with 37<sup>2</sup> new firms opening in 2009 compared with 49 in 2008.

**Table 1: Review of collective investing in 2009**

DECISIONS		2005	2006	2007	2008	2009
Management companies/funds	Management company authorisations	37	51	52	49	37 <sup>(5)</sup>
	Use of EU passport in other EEA states					
	Freedom of establishment	4	6	5	3	5
	Freedom to provide services	23	70	47	93	83
	Use of EU passport in France					
	Freedom of establishment	0	1	1	1	0
	Freedom to provide services	11	10	8	5	5
	Funds created <sup>(1)</sup>	1165	1458	1372 <sup>(4)</sup>	1454 <sup>(4)</sup>	1 042
	Funds authorised o/w:	1074	1247	1 124	1 082	893
	SICAVs	19	27	63	28	18
	General FCPs	797	933	768	757	595
	Venture capital funds	41	46	58	96	106
	Employee profit sharing funds	214	240	231	191	154
	Futures funds	3	1	4	10	20
	Contractual funds declared	26	129	119	126	85
	Streamlined venture capital funds declared	65	82	117	196	44
	Contractual venture capital funds declared	NA	NA	NA	0	1
	Real estate collective investment schemes authorised o/w:	NA	NA	12	50	19
	organised as companies (SPPICAVs)	NA	NA	12	50	19
	organised as funds (FPIs)	NA	NA	0	0	0
Approvals for fund conversions	7700	6701	4281	2663	3600	
Authorisations for European funds <sup>(2)</sup>	341	777	885	838	578	
Approvals of debt securitisation funds (FCC, FCT)/subfunds	6	4	6	10	20	
Approvals of real estate investment trusts, o/w:	37	23	31	19	32	
Opened to the public	6	9	11	6	12	
Capital increases	11	11	10	11	10	
Re-pricing, prospectus updates	20	3	10	2	10	
Approvals of movie investment funds, o/w:	29	13	14	12	11	
Creations	12	10	11	10	11	
Capital increases	17 <sup>(3)</sup>	3	3	2	0	
Approvals of fisheries funds, o/w:	2	0	1	0	0	
Creations	2	0	0	-	-	
Capital increases	0	0	1	-	-	

Source: AMF

(1) creations include fund authorisations and declarations

(2) or sub-funds

(3) incl. 14 additional approvals

(4) The figures given in the 2008 Annual Report have been rectified

(5) 37 authorisation requests were submitted to the Board, but just 25 companies had satisfied the conditions precedent relating to their authorisation at 31 December 2009

<sup>1</sup> The figures given in the 2008 Annual Report have been rectified

<sup>2</sup> At 31 December 2009, 25 companies had received final approval in 2009, and 12 had not yet provided the AMF with evidence that they had satisfied the conditions precedent relating to their authorisation. In 2008, there were 50 final approvals including 44 new companies in 2008 and 6 companies that were approved in 2007 subject to conditions precedent

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## **1 – The AMF's action in 2009**

### **A – Ongoing effects of the financial crisis**

#### **1 > Continued impact of the Lehman Brothers failure**

The collapse of Lehman Brothers<sup>3</sup> affected three French hedge funds. As a result of these developments, the AMF Board was led to issue injunctions against two depositaries that had been given custody of the funds' assets.

The depositaries had appointed Lehman Brothers International (Europe) as sub-custodian of these securities. In its injunctions, the AMF instructed the depositaries to return the securities that had been entrusted to Lehman Brothers International (Europe).

On 8 April 2009 the Paris Court of Appeals rejected the appeals by RBC Dexia and Société Générale against the injunctions issued to them by the AMF Board on 13 November 2008. The two depositary banks returned the assets in question and simultaneously lodged an appeal with the Court of Cassation, which has not yet returned a ruling.

#### **2 > Continued impact of the Madoff fraud on asset management**

When the Madoff fraud first came to light, the AMF put the potential exposure of French funds that had invested in affected Irish and Luxembourg funds at €500 million. That estimate still applies today.

The AMF instructed management companies to inform their clients about the exposure of their funds or mandates to Madoff-impacted funds. The AMF also monitored management companies that wanted to put illiquid assets into side pockets<sup>4</sup>, reorganise their liquidity by setting up redemption gates<sup>5</sup> or changing the frequency with which they calculated net asset value (NAV), or liquidate funds that were no longer able to function properly.

In all, 47 side pocket funds were created for assets affected by the Madoff fraud.

At the same time, the AMF kept a close watch on developments surrounding the liquidation of Luxalpha, a Luxembourg fund that lost virtually all its assets in the fraud and that had been marketed in France. In particular, because some investors had had trouble asserting their shareholder rights, the AMF reminded French custody account keepers of their obligation to facilitate the exercise of these rights by clients invested in Luxalpha.

In addition, the AMF began a series of verifications in the spring of 2009 to check how "Madoff" offshore funds came to be marketed in France. These verifications covered participants such as management companies, FIAs and banks.

#### **3 > Short selling**

On 19 September 2008 the AMF adopted a series of exceptional measures similar to those introduced by regulators in other major financial centres aimed at banning short selling of listed financial stocks.

On 6 November 2008 the AMF announced it was setting up a working group chaired by Board members Marie-Ange Debon and Jean-Pierre Hellebuyck to prepare proposals on a permanent regulatory framework for short selling that could be maintained once the exceptional measures expired.

Considering that the recommended measures could take full effect only if incorporated within an agreement between regulators, or if a harmonised regime could be established at European or international level, the AMF played an active part in IOSCO and CESR discussions on this issue.

CESR held consultations in 2009 on the merits of creating a harmonised framework in Europe for transparency in short economic exposures to shares admitted to trading on a regulated market or an MTF (unless the primary market is outside the European Economic Area). The proposals suggested disclosure to the regulator at an initial threshold (0.1%), followed by a market disclosure at a higher level (0.5%). The report published on 2 March 2010 kept the broad lines of the initial proposals, while raising the first threshold to 0.2% of issued capital. The report also said that national authorities with the necessary legal powers were determined to implement the regime without waiting for Community legislation to be drafted.

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<sup>3</sup> Cf. 2008 Annual Report

<sup>4</sup> Cf. 2008 Annual Report

<sup>5</sup> Cf. 2008 Annual Report

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The AMF is cooperating with the public authorities to look at the procedures and timetable for introducing CESR's regime in France.

Meanwhile, a CESR task force attached to the standing committee for market integrity is working to establish a number of technical provisions, including procedures for calculating positions, with a view to ensuring application of a uniform regime by all Member States.

Against this backdrop, on 26 January 2010 the AMF decided that the provisions introduced on 19 September 2008 to prevent short selling in a list of financial stocks would be maintained until further notice.

#### **4 > Money market funds**

The financial crisis had a heavy and destabilising impact on money market funds, creating a need for discussions about their classification and the type of information provided to investors.

A public consultation was held in early 2009 following work by a group made up of asset management professionals. Once the consultation was over, the AMF set out its views on the future outline of a new classification system for money market funds in Europe. At the same time, CESR began discussions aimed at establishing a Europe-wide definition of "euro money market" funds.

The AMF published its own work as the position that it intended to advocate during CESR's work on this issue.

The AMF thus proposed that money market funds should have maximum sensitivity of 0.5, absolutely no exposure to equity risk, and meet the following criteria:

- > the weighted average life of the portfolio should be less than six months;
- > the maximum residual maturity of securities held in the portfolio should be less than two years;
- > the weighted average life of the portfolio and the maximum residual maturity allowed by the manager or fund should be disclosed in the prospectus in a standardised table (to help differentiate money market funds);
- > a "short-term money market fund" category should be introduced where weighted average life of the portfolio and the maximum residual maturity of securities in the portfolio are reduced to three months and one year respectively;
- > tighter credit risk criteria for securities acquired by funds and improved disclosures on fund credit risk management policies.

As regards disclosures to investors and the marketing of money market funds:

- > use of the term "money market" should be reserved solely for funds that meet the classification criteria;
- > disclosures about money market funds should not portray these products as risk-free. The prospectus should make it clear that a fund offering a return in excess of the money market rate, less management expenses, is inevitably riskier than a fund that confines itself to the money market return;
- > money market funds that employ unusual financial instruments or strategies should be marketed only to investors who are capable of assessing the associated risks and rewards. Accordingly, products with unusual risk profiles should not be marketed to non-expert investors;
- > the prospectuses of money market funds should give precise information about the instruments and strategies used, and list them explicitly.

At end-October 2009 CESR published a consultation paper to gather feedback from the industry on this issue. The consultation ran until 31 December 2009.

The work that follows the consultation and the way it is distilled should make it possible to adopt a harmonised position at European level and introduce a harmonised classification system by 1 July 2010. It is vital to arrive swiftly at a common solution in this area, where the French asset management industry is a major force.

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## 5 > Introduction of redemption gates and side pockets

The sharp deterioration in liquidity on certain markets in 2008 continued in 2009. This prompted many foreign alternative funds to suspend redemptions or activate redemption gates. This naturally affected the liquidity of French funds of hedge funds (FoHFs) with exposure to these vehicles.

To ensure fair treatment for investors, three legislative and regulatory amendments were made to give funds with streamlined investment rules more flexibility in liquidity management through procedures that were better suited to the economic conditions created by the crisis.

Two measures were introduced in October 2008:

> management companies were allowed to modify their liquidity arrangements by changing the frequency of NAV calculation (at least monthly) or by increasing the period between when a redemption order is centralised and settled<sup>6</sup> (60 days maximum).

Around 30% of French authorised FoHFs (accounting for 53% of assets) made changes to their liquidity arrangements;

> management companies were also allowed to introduce redemption gates<sup>7</sup>. Under this mechanism, the company can spread out fund redemptions over several NAV calculation periods if redemption orders exceed a predetermined percentage of the fund's net assets. One hundred or so funds have thus far introduced gating mechanisms.

Until April 2009, management companies could introduce these measures immediately without letting investors exit free of charge (if they disagreed with this significant change to fund rules) and after having individually informed them.

Furthermore, since the end of 2008, management companies have been allowed to create side pocket funds for assets whose disposal would not be in the interest of unitholders or shareholders<sup>8</sup>.

Unlike the liquidity management measures, which are only for streamlined CIS, the side pocket mechanism applies to all French CIS<sup>9</sup>.

Assets are segregated by splitting the original fund into two new funds:

> a clone fund that replicates all the characteristics of the original fund, including its management objective, investment strategy, risk profile and expenses;

> a contractual "side pocket" fund managed in run-off mode, to which assets whose sale is not in the interest of unitholders are transferred. The fund's units or shares may not be bought or redeemed until the fund's effective dissolution date.

In 2009 30 management companies reported around 60 side pocket funds to the AMF.

## B – Adapting the regulatory framework

### 1 > Shareholders of asset management companies

The procedures for reporting ownership changes at asset management companies, and for having these modifications approved by the AMF, changed on 1 January 2010. Further to the transposition of Directive 2007/44/EC concerning the prudential assessment of acquisitions and increases in equity holdings in financial sector entities, amendments were made to the AMF General Regulation<sup>10</sup> and to Instruction 2008-03 of 8 February 2008<sup>11</sup>.

The two main changes that came into force on 1 January 2010 were as follows:

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<sup>6</sup> According to Article 413-19 of the AMF General Regulation, this period may not exceed 60 days if NAV is not calculated daily

<sup>7</sup> Article L. 214-35 of the Monetary and Financial Code

<sup>8</sup> Article L. 214-30 of the Monetary and Financial Code

<sup>9</sup> Streamlined CIS are excluded

<sup>10</sup> Articles 312-11 to 312-15 of the AMF General Regulation

<sup>11</sup> On the procedures, terms and conditions of authorisation and on the programmes of operations of asset management companies and investment services providers carrying on the business of asset management or investment advice, Article 8 and Annexes 2, 5 and 6 of the Instruction

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> the AMF must receive prior notice of any change that results in ownership of a management company going above or below certain set thresholds. Previously, only modifications that caused a change in control had to be reported;

> the new reporting thresholds are 10%, 20%, 33,3% and 50% of voting rights or 50% of capital.

In December, the AMF published a set of Q&A<sup>12</sup> to help the industry get to grips with the new provisions.

## **2 > Overhauling the Instructions on private equity**

Since the Instructions issued on 6 June 2000 were no longer suited to the situation in the private equity fund sector, they were recast as four new Instructions<sup>13</sup>, as follows:

> Instruction 2009-03 of 2 April 2009 on authorisation procedures and on disclosures to investors in venture capital funds;

> Instruction 2009-04 of 2 April 2009 on reporting procedures and on disclosures to investors in venture capital funds subject to the streamlined procedure;

> Instruction 2009-05 of 6 June 2009 on the complete prospectus of authorised venture capital funds;

> Instruction 2009-06 of 6 June 2009 on the complete prospectus of venture capital funds subject to the streamlined procedure.

The new Instructions are essentially intended to:

> incorporate legislative and regulatory amendments adopted since 2000, particularly by extending the scope of the Instructions to reflect changes in venture capital products (such as the introduction of local investment funds in 2003, and pre-liquidation arrangements);

> update the procedures for establishing and modifying funds based on the type of change and the type of product affected;

> leverage the contents of the Geco funds database<sup>14</sup>, with a view to:

> using the same terminology for all CIS;

> bringing the current procedures on issuing AMF authorisations into line with standards (harmonisation of deadlines, etc.);

> adding procedures for the electronic transmission of prospectuses (fund circulars and bylaws);

> making sure that modifications during the fund's lifetime are tracked;

> making the prospectuses of private equity funds offered to subscribers available to the general public.

## **3 > Instructions on contractual venture capital funds**

The Economic Modernisation Act 2008-776 of 4 August 2008 created contractual venture capital funds, a new type of private equity collective investment vehicle, and established the main operating principles for the new funds.

The AMF General Regulation supplemented the legal arrangements governing these funds by inserting a special section on contractual venture capital funds into the chapter devoted to venture capital funds in Book IV. The new section covers constitution, bylaws, operating rules (minimum assets, subfunds, mergers, liquidation, etc.), subscriptions and redemptions.

Some of the provisions in the section indicate that notification and disclosure procedures are set out in an AMF Instruction. The procedures in question are essentially the same as those that apply to venture capital funds subject to streamlined procedures.

Accordingly, the provisions of Instruction 2009-04 of 2 April 2009 on notification procedures and on disclosures to investors in venture capital funds subject to streamlined procedures<sup>13</sup> have been extended to contractual venture capital funds.

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<sup>12</sup> Available on the AMF website ([www.amf-france.org](http://www.amf-france.org)) under Publications > Guides > Professional Guides

<sup>13</sup> Available on the AMF website ([www.amf-france.org](http://www.amf-france.org)) under Texts > Access by category of text > AMF Instructions

<sup>14</sup> Where the internet user can consult information on French CIS (CIS, real estate CIS and SCPIs) and management companies (asset managers, collective investment managers, SCPI managers).

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To complete the arrangements, Instruction 2009-09 of 3 November 2009 on the full prospectus of contractual venture capital funds<sup>13</sup> established the content requirements for full prospectuses.

#### **4 > Updating the Instructions on general purpose CIS**

Instruction 2005-01 of 25 January 2005 on the authorisation and periodic reporting requirements for French CIS and foreign CIS marketed in France<sup>13</sup> and Instruction 2005-02 of 25 January 2005 on the complete prospectus of CIS authorised by the AMF, with the exception of futures funds, venture capital funds, innovation funds, local investment funds, employee profit-sharing funds and SICAVs for employee shareholders<sup>13</sup>, were amended in May 2009 to accommodate changes to:

- > the AMF General Regulation on the frequency of fund valuation;
- > the Monetary and Financial Code and the AMF General Regulation allowing management companies to create side pocket funds for assets whose disposal would not be in the interest of investors;
- > the Monetary and Financial Code and the AMF General Regulation to allow a streamlined or contractual CIS or its management company to reach an agreement with the fund depository setting out the depository's continued obligations as part of its custody account-keeping services;
- > the Monetary and Financial Code allowing streamlined CIS to establish gates at NAV calculation dates.

#### **5 > New Instructions on real estate collective investment schemes**

As part of the process of finalising the regulatory arrangements for real estate CIS, Instruction 2009-01 of 6 January 2009 on the authorisation and periodic reporting procedures for real estate CIS and Instruction 2009-02 of 6 January 2009 on the full prospectus of real estate CIS<sup>11</sup> were drafted based on the Instructions for general purpose CIS. These new Instructions reflect the special characteristics of real estate investing and cover, respectively, authorisation procedures and the procedures for preparing regulatory documentation for real estate CIS.

The Instruction on authorisation and periodic reporting procedures informs management companies about how these products are authorised when they are initially created and if they are modified.

The Instruction on the full prospectus of real estate CIS provides a clear model prospectus that professionals can use to prepare a document that investors will understand.

The Instruction was amended in summer 2009 to address demands from professionals concerning the disclosure of expenses, to help provide useful information to investors and make it easier to compare products.

#### **6 > AFG Code of Ethics**

The French Asset Management Association (AFG) updated its code of ethics for CIS and discretionary management to reflect regulatory amendments, particularly the entry into force in November 2007 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

After approving the code as a set of professional rules and seeking the opinion of the French association of credit institutions and investment firms, AFCEI, the AMF Board extended application of the code to all ISPs, to harmonise the rules applicable to investment management. Accordingly, the AMF may now issue injunctions or penalties<sup>15</sup> against any professional carrying on the business of discretionary or CIS management that breaches the code's provisions.

#### **7 > Combating money laundering and terrorist financing**

Transposition of Directive 2005/60/EC of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing necessitated an amendment to the AMF General Regulation<sup>16</sup>. The change was needed to specify the obligations placed on professionals

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<sup>15</sup> Article L. 621-14 of the Monetary and Financial Code (injunctions) and Article L. 621-15 of the Monetary and Financial Code (sanctions).

<sup>16</sup> The Order of 12 November 2009 approving amendments to the AMF General Regulation was published in the Official Journal of 18 November 2009. The new provisions of the General Regulation, which amend Books III and V, help to complete the transposition into French law of the Third Anti-Laundering Directive, a process begun by the Executive Order of 30 January 2009 and its implementing decrees of 16 July 2009 and 2 September 2009

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under AMF supervision, whether they are asset management companies, central securities depositaries, operators of securities settlement systems and FIAs.

## **8 > Closed-end real estate investment companies**

Article 321-44 of the AMF General Regulation was amended to allow the management companies of real estate investment companies to assign the task of determining the unit execution price once the order register is closed either to an ISP running a multilateral trading facility or to a market operator. These outsourced activities are performed under the responsibility of the management company.

## **9 > Fund administration (centralisation of subscription and redemption orders for units or shares issued by CIS, accounting recognition of creations/destructions of units or shares)**

Building on work conducted by the AMF on the depositary function<sup>17</sup>, an AMF-led working group made up of representatives of the AFG and AFTI met in 2009 to open discussions about CIS fund administration. The working group was given four objectives:

- > define the tasks involved in fund administration, particularly those relating to centralising subscription and redemption orders and to maintaining fund issuance accounts;
- > clarify the role of participants, by specifying the scope of their responsibilities and outsourcing options;
- > make the order placement system more secure, which will help with CIS marketing, particularly in an open-architecture or cross-border distribution approach;
- > change the regulations to include the possibility for management companies to receive orders directly from investors, particularly foreign investors, and their representatives.

It is expected that this work will result in the adoption of regulatory provisions on fund administration over the course of 2010.

## **C – Dissemination of AMF positions and policy**

### **1 > Updating policy on CIS**

As part of its Better Regulation approach, the AMF committed itself to regularly updating and disseminating its policy on CIS.

In 2009 the AMF pursued these efforts by updating three documents:

#### **a) Drafting guide for fund prospectuses<sup>18</sup>**

The guide is intended to help management companies to draft regulation-compliant prospectuses and circulars. The information that the fund is required to publish must be transparent, complete and clear. For this, the guide:

- > reviews a number of applicable rules and how to apply them;
- > sets out recommendations on applying these rules;
- > identifies frequently encountered good and bad practices to illustrate the rules and recommendations.

For the most part, the additions to the guide in 2009 were intended to clarify the main headings of the simplified fund prospectus:

- > classification: to avoid misuse, the guide emphasises that the term "diversified" should be used only for funds that do not come under any other classification;
- > management objective: this should be consistent with the management approach used by the fund to achieve it. Accordingly, if a fund wants to provide investors with a return in excess of the "risk-free" money market rate by seeking out instruments other than the safest money market investments, it should not state that its objective is to protect capital, since this would not be representative of the risks taken on by the fund;
- > investment strategy: if the investment strategy when the fund starts up is different from the strategy that is ultimately pursued, the full prospectus should indicate this and describe the strategies implemented;

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<sup>17</sup> Order of 18 April 2007 of the Ministry for the Economy, Finance and Industry approving the amendments to the General Regulation in this regard

<sup>18</sup> Available on the AMF website ([www.amf-france.org](http://www.amf-france.org)) under Publications > Guides > Professional Guides

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> the guide was also amended to clarify the terms used to describe the operation of structured funds.

### **b) Monitoring CIS practices: summary of observations**

The purpose of this document is to inform asset management companies, depositaries and auditors about the AMF's main comments in relation to its monitoring of CIS. They can then take these comments into account when preparing and implementing their own control systems. The document therefore reviews applicable regulations, gives recommendations on applying them and provides example cases of compliance and non-compliance with the regulations.

The main observation made in 2009 concerned management of the fund liquidation process. In 2009 management companies wound up many CIS whose assets had shrunk because of numerous redemptions. The AMF observed that many asset management companies had failed to prepare themselves for the longer-term aspects of fund management. Accordingly, it reminded professionals of the need to take measures to:

> enable early identification of situations that might cause assets to shrink to a level at which the fund could no longer be managed in the interest of investors;

> establish and implement measures to ensure that investors' interests are served, including measures to gather new subscriptions to maintain the fund's assets at an adequate level, or to switch, merge or dissolve the fund if assets cannot be maintained at an adequate level.

### **c) Guide to best practices in drafting marketing literature<sup>19</sup>**

One of the AMF's priorities is to monitor the way that CIS are marketed.

The AMF publishes its analyses of marketing documents to inform the industry about practices that are felt to be inconsistent with the current regulations as well as those that are deemed likely to enhance information quality. The guide provides real-life examples to illustrate the regulations and facilitate their application.

In 2009 the AMF reminded participants<sup>20</sup> that ISPs must ensure that all the information, including marketing information, that they send to, or that is likely to be read by, retail clients must be "clear, accurate and not misleading". Accordingly, the asset management company and the distributor of the products are responsible for ensuring that the information they disseminate complies with Articles 314-11 to 314-17 of the AMF General Regulation.

In this connection, the AMF drew attention to the use of misleading terms in marketing literature, particularly in materials relating to structured funds.

Funds whose objective is to replicate the performance of a financial index may have unusual characteristics. The index may for example incorporate a special strategy intended to deliver certain returns or to outperform the benchmark. In such cases, the literature on this type of fund must not obscure important elements in the index construction process. Moreover, the management company must be careful to avoid conflicts of interest if the index that it is trying to replicate is calculated and disseminated by entities within the same group.

## **2 > AMF position on managing conflicts of interest within asset management companies managing real estate CIS**

Building on its Better Regulation approach, the AMF prepared a review of the first set of authorisations for asset management companies managing real estate CIS, by publishing a position on conflict-of-interest management within this type of company<sup>21</sup>.

The document is organised around the most common issues in this regard, including the position of senior executives who are "shared" by several entities that do business in real estate; the determination of investment targets that are shared by several entities; the procedures for dividing targets between several investment companies or vehicles; the selection of intermediaries that are liable to be involved in managing real estate CIS; and procedures for taking investment decisions.

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<sup>19</sup> Available on the AMF website ([www.amf-france.org](http://www.amf-france.org)) under Publications > Guides > Professional Guides

<sup>20</sup> In accordance with Article 314-10 of the AMF General Regulation

<sup>21</sup> Available on the AMF website (<http://www.amf-france.org>) under Texts > Access by category of text > AMF Positions

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The position is intended to provide guidelines for professionals that are in this type of situation, to help them adjust their organisation, conflict-of-interest procedures and control systems.

## D – Issuance of professional licences to compliance officers

### 1 > Issuance of Investment Services and Compliance Officer licences

The number of candidates sitting the exam for an Investment Services and Internal Control Officer (RCSI) licence in 2009 was down 18% on the previous year. This is due to a lower rate of turnover in compliance teams and the fact that fewer major banks reorganised their compliance function than in 2008.

**Table 2: Change in number of RCSI licences issued**

RCSI	2008		2009	
	19th session	20th session	21st session	22nd session
Number of people who took the AMF training course*	79	60	50	56
Candidates sitting the exam **	48	40	33	38
RCSI licences awarded	39	34	28	28
Rejections	9	6	5	10
Pass rate***	81%	85%	85%	74%
% of exam candidates relative to number of persons trained	61%	67%	66%	68%

Source/ AMF

\* Not all persons who sign up for training necessarily sit the exam.

\*\*Not all exam candidates had previously signed up for training.

\*\*\* % of RCSI licences awarded relative to the number of exam candidates.

There were three main reasons for failing a candidate:

- > lack of experience in the function;
- > unclear presentation, thus preventing the jury from reaching an opinion;
- > organisational shortcomings in the compliance function (inadequate resources, problems with the RCSI's reporting lines, risk that the licence-holder's authority would be watered down if several licences were issued to persons in the same firm, unclear division of tasks where the RCSI's duties are performed by several people, etc.).

Most of the failed candidates passed the exam at the next session, having remedied the failings identified by the jury. In a substantial number of cases, a licence was issued but the jury attached conditions or made critical remarks.

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## 2 > Issuance of Compliance and Internal Control Officer licenses

In 2009 the AMF noted a fall in the number of candidates applying for a Compliance and Internal Control Officer (RCCI) licence. As with the RCSI exams, the decline is probably due to a lower rate of turnover in compliance teams at asset management companies.

**Table 3: Issuance of RCCI licences**

RCCI	2008		2009	
	19th session	20th session	21st session	22nd session
Number of people who took the AMF training course*	45	50	35	41
Candidates sitting the exam**	22	42	25	26
RCCI licences awarded	18	36	18	23
Rejections	4	6	7	3
Pass rate***	82%	86%	72%	88%
% of exam candidates relative to number of persons trained	49%	84%	71%	63%

Source/ AMF

\* Not all persons who sign up for training necessarily sit the exam.

\*\*Not all exam candidates had previously signed up for training.

\*\*\* % of RCCI licences awarded relative to the number of exam candidates.

The motives for failing a candidate were similar to those mentioned in the case of the RCSI licence. In small management companies, it was noted in several instances that the candidate had the personal qualities needed to discharge compliance duties but that the compliance and internal control function itself was not up to standard.

## 3 > Request for a jury opinion when the RCCI function is outsourced

**Table 4: Number of outsourcing cases submitted to the jury**

	2008		2009	
	2nd session	3rd session	4th session	5th session
Management companies appearing before the jury for an opinion	25	15	18	8
Accepted	25	13	15	8
Rejected	0	2	3	0

Source: AMF

The number of firms for which the AMF deemed it necessary to seek the jury's opinion was some 35% lower than in 2009. The number of companies formed in 2009 that outsource their compliance and internal control function was stable relative to 2008.

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## 4 – Work by the consultative commission and cross-industry groups on individual and collective asset management

### A – Work by the Consultative Commission on Individual and Collective Asset Management

#### **Composition:**

Philippe Adhémar, Chairman

Jean-Pierre Hellebuyck, Vice-Chairman

Francis Ailhaud (Groupama Asset Management), Christian Boisson (Crédit Agricole Asset Management), Dominique Carrel-Billard (AXA-IM), Raymond de Courville (AM Capital), Alexandre Gautier (Banque de France), Guillaume Jalenques de Labeau (SPGC<sup>22</sup>), Pierre Jolain (Haas Gestion), Gérard Pfauwadel (Unigestion AM), Alain Pietrancosta (Paris-I-Sorbonne university), Hélène Ploix (Pechel Industries), Bruno Prigent (Société Générale), Antoine de Salins (FRR<sup>23</sup>), Patrick Sellam Cabinet Patrick Sellam), Etienne Stofer (CRPN<sup>24</sup>), Pascal Voisin (Natixis AM).

The Consultative Commission on Individual and Collective Asset Management is a forum for dialogue with professionals from all sectors of the asset management industry, i.e. not just asset managers but also depositaries, institutional investors and academics. It continued its work in 2009, meeting ten times.

The commission was consulted on a wide range of issues, including technical reforms to the regulatory framework for SICAFs (closed-end investment funds), work on money market funds, amendments to the AMF General Regulation on the option of drafting fund documentation in a language other than French that is customary in the field of finance, and on combating money laundering and terrorist financing, proposals to recast AMF Instructions on venture capital, venture capital funds and real estate CIS, amendments to classifications for investment funds (other than money market funds), changes to the frequency of fund valuation, the introduction of side pockets for assets whose sale would not be in the interest of investors<sup>25</sup> and gating mechanisms at NAV dates for CIS subject to streamlined investment rules<sup>26</sup>.

The commission paid special attention to international and particularly European regulatory developments in 2009. It examined the draft technical advices prepared by CESR on Level 2 measures for the UCITS IV Directive concerning the management company passport and Key Information Document. It gave an opinion on CESR's draft recommendations on the implementation of arrangements for inducements and provided feedback to CESR's consultation on the concept of investment advice under MiFID. It also gave an opinion on the appropriate response by French authorities to the consultations held by the European Commission on UCITS depositaries, on applying the Investor Compensation Schemes Directive and on applying the Prospectus Directive. It also monitored the European Commission's work on retail investment products, as well as work by IOSCO<sup>27</sup> on hedge funds<sup>28</sup>. It was kept informed about, and was able to issue opinions on, the provisions of the draft AIFM Directive<sup>29</sup> being debated by the European Council and the Parliament.

The commission was also consulted on and discussed a number of topical issues relating to asset management, including the effects of the Madoff fraud on asset management and the role and responsibilities of the depositary, the arrangements for short selling, the impact of the crisis on the alternative management industry in France, and work on fund administration.

The commission examined the AMF's positions on conflicts of interest within management companies managing real estate CIS, the risk management arrangements of management companies implementing quantitative investment strategies, and the update to the AMF's positions on fund prospectuses, monitoring and marketing of CIS.

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<sup>22</sup> Société Privée de Gestion et de Conseil

<sup>23</sup> Fonds de réserve pour les retraites

<sup>24</sup> Caisse de retraite du personnel navigant

<sup>25</sup> Cf. 2008 Annual Report

<sup>26</sup> Cf. 2008 Annual Report

<sup>27</sup> International Organization of Securities Commissions

<sup>28</sup> Final report by the Task Force on Unregulated Entities

<sup>29</sup> Proposal for a Directive by the European Commission of 29 April 2009 on Alternative Investment Fund Managers

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## B – Work by cross-industry groups

The UCITS IV Directive<sup>30</sup> must be transposed into national law by 1 July 2011 at the latest. The Directorate General for the Treasury and Economic Policy (DGTPE) will direct the implementation process, with the assistance of the AMF. Given the issues at stake – the significant opening-up of the French market to foreign funds, a potential increase in UCITS electing to register in other financial centres, and possible relocations of management companies – the AMF wanted to take this opportunity to think about how to continue to safeguard investments while promoting a vibrant financial marketplace.

The first stage was to talk with the industry to get a sense of its expectations and strategies. It became clear that professionals were planning to rationalise fund families, chiefly by creating master-feeder funds, and were considering using the asset management passporting arrangements to optimise group-wide operating costs and expand their client base. The discussions also revealed weaknesses in the French financial centre in two areas: subscription/redemption order management services offered to international clients, and a lack of knowledge about French funds and regulations outside France's borders.

To conduct the project, in December 2009 the AMF created an asset management stakeholder committee to prepare an action plan, which will act as a roadmap for the AMF and the French financial community as a whole. Co-chaired by Jacques Delmas-Marsalet and Jean-Pierre Hellebuyck, the committee is made up of asset management practitioners, management industry associations, representatives of institutional and retail investors, the DGTPE, market authorities and Paris Europlace.

The committee focused on four areas: promotion of the French regulatory system, regulation of products and marketing, regulation of management companies, fund administration and the full range of services provided to investment funds. Work began in mid-December and was scheduled to be completed by early May. A draft report on the committee's work will be put out to public consultation prior to publication.

## 5 – International cooperation on asset management

### A – Work by IOSCO on investment management (SC5)

The AMF chairs IOSCO's standing committee on investment management (SC5). Over the course of 2009, given the impact of the financial crisis, the committee concentrated on asset management-related issues identified by the G20, including supervision and reduction of systemic risk.

#### 1 > Work by SC5 in connection with the effects of the crisis

##### **a) Due diligence by managers of funds offered to the public when investing in structured financial instruments**

In July 2009 SC5 published a guide to the due diligence that should be carried out by the investment managers of funds offered to retail investors both before and during investments in structured financial instruments (SFIs).

Drawn up in close cooperation with the industry, the guide was largely informed by the discussions of an AMF-chaired working group made up of industry representatives and SC5 members<sup>31</sup>.

The guide sets out five key messages that firms should keep in mind when assessing their due diligence policies and procedures. One recommendation to managers is that if they do not understand a structured financial instrument, they should not buy it. The guide also points out that SFI investing is different from investing in more conventional instruments and calls for a tailored due diligence process.

The guide sets out best practices for managers in each of the three stages that make up a due diligence process, namely assessing and monitoring:

1. the underlying assets of the SFI in which it is invested;
2. the structure of the SFI (including the associated risks and the roles of different parties); and
3. the consistency of the investment, with the fund's investment objective and characteristics and with the manager's organisation and resources.

<sup>30</sup> Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities

<sup>31</sup> The SC5 regulators that belong to the working group are France's AMF, Germany's BaFin, Italy's Consob, the UK Financial Services Authority and the US Securities and Exchange Commission

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The guide also deals with good practices in situations where the manager uses a third party in the due diligence process (e.g. ratings).

#### **b) Due diligence for managers of funds of hedge funds**

In September 2009 SC5 also published due diligence general principles for managers of funds of hedge funds (FoHF) in two areas: liquidity risk management and the nature and the conditions of the due diligence process used by FoHF managers prior to and during investments on behalf of the funds they manage. SC5 had previously flagged these two areas of concern in its June 2008 report on FoHFs<sup>32</sup>. These principles round out those already published by IOSCO's Technical Committee in November 2007 on the valuation of hedge fund portfolios<sup>33</sup> and in June 2009 on hedge funds.

#### **c) Prevention and management of conflicts of interest by private equity firms**

Between 3 November 2009 and 1 February 2010 IOSCO held a public consultation on eight general principles to prevent and manage conflicts of interest that may arise in connection with the activity of private equity firms, as highlighted in the report on private equity<sup>34</sup> published by the Technical Committee of IOSCO in June 2008. The document sets out ways to mitigate the chief conflict-of-interest risks encountered over the life cycle of a private equity fund. The principles are intended to be readily applicable to all private equity firms, regardless of their size, structure and activity.

### **2 > SC5 work on protecting CIS investors and shareholders**

#### **a) Key information disclosures to retail investors relating to CIS prior to or at the point of sale**

SC5 and SC3, IOSCO's standing committee on the regulation of market intermediaries, published for public consultation a report setting out the key information to be provided to retail investors before they invest in a CIS. The report proposes six basic principles for professionals that create and/or distribute CIS to ensure that investors are properly informed.

The consultation, which ran until 16 February 2010, highlighted the importance of providing investors with accurate, meaningful and understandable information to enable them to take informed investment decisions. Once the consultation feedback has been analysed, general principles on key information disclosures for CIS investors should be finalised and published in 2010.

#### **b) Suspensions of CIS subscriptions and redemptions**

In February 2009 SC5 began work on the suspension of redemptions relating to funds offered to the public. It undertook this project in response to a number of suspensions that occurred in many jurisdictions, even though the ability to redeem at any time is a fundamental investor right. SC5 wants to identify the main issues linked to the lack of a common approach in this area and to develop, if appropriate, general principles to help CIS avoid and manage suspensions under the best possible conditions for investors. SC5, which will involve industry in its work, is expected to receive a specific mandate from IOSCO's Technical Committee in early 2010 to devise an appropriate framework for situations in which the redemption rights of CIS investors may be temporarily suspended.

#### **c) Protection and segregation of client assets**

Acting on a proposal by the AMF and the US Securities and Exchange Commission, SC5 initiated discussions on the question of whether, in the light of the defaults connected with the Madoff fraud, IOSCO's 1999 regulatory principles<sup>35</sup>, particularly those pertaining to the protection and segregation of client assets, needed to be strengthened. SC5 will coordinate its preliminary analysis with the IOSCO implementation task force, which is chaired by AMF and whose task is to update IOSCO's principles in 2010.

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<sup>32</sup> "Report on Funds of Hedge Funds—Final Report of the Technical Committee of IOSCO".

<sup>33</sup> "Principles for the Valuation of Hedge Fund Portfolios—Final Report of the Technical Committee of IOSCO – November 2007".

<sup>34</sup> "Report on Private Equity—Final Report of the Technical Committee of IOSCO".

<sup>35</sup> "IOSCO Objectives and Principles for Securities Regulation".

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### 3 > SC5 medium-term work programmes

The current environment has led SC5 to focus its work on exchange traded funds (ETF), particularly on identifying potential regulatory issues connected with ETFs, and on CIS valuation. This work may entail updating the principles published by IOSCO's Technical Committee in 1999 (on CIS<sup>36</sup> and in 2007 (on hedge funds<sup>37</sup>).

Furthermore, as part of its contribution to the work of the Financial Stability Board on the supervision of systemic risk, SC5 is considering holding discussions on topical issues, such as the identification of potential systemic risks associated with certain investment funds, and asset manager remuneration policies.

## B – Community initiatives and bilateral exchanges: CESR-IM, cooperation with the European Commission and bilateral cooperation

### 1 > UCITS IV Directive

The AMF continued and stepped up its involvement in CESR's work on collective investment management, which is being taken forward by the Expert Group on Investment Management (CESR-IM).

#### Technical advice on implementing measures for the UCITS IV Directive

In February 2009 CESR-IM received a provisional mandate (the UCITS IV Directive had not yet been definitively adopted by the European Council)<sup>38</sup> to provide advice on technical implementing measures for the directive. The mandate covered three areas:

- > the management company passport;
- > the Key Information Document;
- > fund mergers, master-feeder structures and the new notification procedure.

These projects accounted for the bulk of the work done by CESR-IM in 2009.

#### CESR's technical advice on Level 2 measures of the UCITS IV Directive relating to the management company passport.

One of the major contributions made by the UCITS IV Directive is the effective implementation of passporting arrangements for management companies. From July 2011, when the directive comes into force, management companies will be able to create and manage funds located in other Member States.

Accordingly, the UCITS IV Directive (Level 1) requires the Commission to adopt implementing measures for the management company passport before 1 July 2010, in several areas:

- > organisational requirements for management companies, including measures to reduce conflicts of interest and rules of conduct;
- > risk management rules;
- > rules governing relations between the depositary and the management company when the two entities are located in different Member States; and
- > rules for the cross-border supervision of participants located in different Member States.

To prepare its advice, CESR-IM set up several technical groups. The AMF chaired the one on depositaries. Following a public consultation on the draft technical advice from July to September 2009, CESR submitted its final advice to the European Commission on 28 October 2009.

The Level 2 measures proposed by CESR regarding organisational requirements, including measures to reduce conflicts of interest and rules of conduct, draw heavily on the Markets in Financial Instruments Directive (MiFID), while accommodating the specific features of the collective management business. The AMF is pleased about these developments, which seek to introduce a regime that has already applied to management companies in France since MiFID came into effect on 1 November 2007 and thus are

<sup>36</sup> "Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes–Report of the Technical Committee of IOSCO–May 1999".

<sup>37</sup> "Principles for the Valuation of Hedge Fund Portfolios–Final Report of the Technical Committee of IOSCO–November 2007".

<sup>38</sup> Adopted by the European Council on 22 and 23 June 2009

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unlikely to cause upheaval. One of the main changes is that the management company's remuneration policy must be set out formally and meet specific requirements in terms of transparency and preventing conflicts of interest, in accordance with the European Commission's recommendation of 30 April 2009 on remuneration policies in the financial services sector.

The Level 2 measures proposed by the group chaired by the AMF for the rules governing relations between the depositary and the management company when the two entities are located in different Member States involve the establishment of a basic set of common information to be included in the agreement between the management company and the depositary to enable each participant to fulfil its duties as required under the UCITS IV Directive.

The technical advice provides for a harmonised risk management framework at European level to ensure a high level of investor protection. The advice incorporates the AMF's suggestions on requiring the management company to supervise third parties to which risk management and valuation activities have been entrusted, and on the due diligence to be carried out by such third parties. Furthermore, the advice covers the introduction of a harmonised risk measurement methodology to compute the global exposure of funds, which is to be the subject of work by CESR at Level 3.

The technical advice proposes detailed rules for cross-border supervision covering exchanges of information and on-the-spot verifications and investigations, which draw on MiFID and Market Abuse Directive rules. The AMF made sure that the proposed measures clarified the conditions governing the three possibilities provided for in the Level 1 legislation on cross-border supervision.

#### CESR's technical advice on Level 2 measures of the UCITS IV Directive relating to the Key Information Document

The directive (Level 1) requires the Commission to adopt implementing measures related to the Key Information Document before 1 July 2010.

The goal of the document is to simplify information and refocus it on essential product characteristics, to provide the key information needed for investors to take enlightened investment decisions.

In February 2007 the European Commission gave CESR a mandate to prepare technical advice on implementing measures relating to the introduction of the Key Information Document (KID). The mandate was supplemented in February 2009 to take account of the final changes to the UCITS IV Directive. The AMF contributed actively to work on reforming the simplified prospectus by co-chairing, with the UK Financial Services Authority, the working group on this question, which worked for two and a half years to prepare the technical advice.

CESR's draft technical advice on Level 2 measures was put out to a public consultation that ran until 10 September. CESR submitted its final advice to the European Commission at end-October 2009. This was supplemented by the publication in late December 2009 of annexes on methodologies for calculating operating and management expenses and the risk/reward indicator.

The technical advice recommended that the KID should not exceed two pages (three for structured funds).

Headings follow a prescribed wording and order. The KID will include a short description of the investment objectives and investment policy, the investment's risk/reward profile, costs and charges, and a past performance presentation or performance scenarios where past performance presentation is not appropriate, and information about where the full prospectus and the yearly reports may be obtained.

Key information should be written in non-technical language that is understandable to retail investors. To facilitate the implementation of these measures, the advice proposes that CESR should publish sample KIDs for illustrative purposes. Furthermore, to assist with the education of investors across Europe, the advice suggests conducting work with consumer associations to create a glossary of terms. These measures should ultimately be the subject of CESR recommendations.

The experience of the current simplified prospectus has shown that presenting the risk/reward profile through a literal description of risks does not work. The AMF therefore suggested preparing a quantitative indicator supplemented with a literal presentation of the main specific risks that are not captured by the methodology used to compute the indicator.

In the case of structured funds whose returns are based on a formula, the AMF successfully argued for forward-looking performance scenarios.

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### CESR's technical advice on Level 2 measures of the UCITS IV Directive relating to fund mergers, master-feeder structures and the new notification procedure

One of the key contributions made by the UCITS IV Directive is the reform to the arrangements for fund notifications, cross-border fund/sub-fund mergers and cross-border master-feeder structures.

CESR's work in this area has followed a slightly different timetable to the work on the other Level 2 measures on the management company passport and the KID.

The AMF contributed actively in all three areas of this work.

CESR's draft technical advice on Level 2 measures was put out to public consultation until 17 November 2009. CESR submitted its final advice to the European Commission in late 2009.

The Level 2 measures proposed by CESR for mergers deal chiefly with the content of the information that should be provided to unitholders affected by the merger, particularly the information needed for them to assess the impact of the merger on their investment. This question is especially important when unitholders are located in different Member States. CESR's advice establishes a number of minimum requirements covering:

- > details of the merger so that affected unitholders (particularly those of the merging fund) can assess the impact of the merger on their investment;
- > providing a copy of the new fund's KID to unitholders of the merging fund;
- > information about the merger procedure and timetable;
- > how unitholders can exercise their rights.

National regulators, including the AMF, may strengthen these rules.

On master-feeder structures, the proposed Level 2 measures provide for detailed measures in the event of the liquidation, merger or division of the master fund.

On the procedure for regulators to provide notifications to each other and the conditions for host country regulators to obtain fund documentation, the advice provides initially for an email-based notification procedure. Further out, a common European database could be set up, subject to additional work by CESR on the feasibility and cost of such an option.

### **2 > Other issues tackled by CESR-IM**

Other issues tackled by CESR-IM in 2009, particularly work done by the operational task force on the effects of the financial crisis and the Madoff fraud, focused chiefly on depositaries and money market funds.

On the question of depositaries, work concentrated on clarifying the role and responsibilities of UCITS depositaries. For this, CESR carried out a mapping of the regimes applicable to depositaries in different Member States. The results highlighted the deep differences between Member States in this regard, underscoring the need for corrective measures at European level. The AMF believes that it is vital to move towards a harmonised depositary regime in Europe. A working group chaired by the AMF also prepared a response to the consultation organised by the European Commission on UCITS depositaries.

The AMF defended its position on the proposed European definition for money market funds, which was the subject of a consultation until 31 December 2009. CESR will finalise its draft Level 3 recommendations based on the consultation feedback in the first quarter of 2010.

The AMF also continued to make a major contribution to the debate opened by the expert group on short selling in the light of the legal framework of the UCITS Directive and the impact of the financial crisis.

### **3 > Bilateral cooperation**

In 2009 the AMF worked on a bilateral basis with its main partners on issues relating to the regulation of collective management. It cooperated extensively with its UK counterpart, notably as part of co-chairing the CESR-IM working group on the KID. In this context, it developed its strategy of organising exchanges with fellow regulators in a bid to reach shared positions ahead of milestone meetings in multilateral negotiations. For example, the AMF held discussions with UK, German, Italian, Spanish, Irish and Luxembourg regulators on the draft AIFM Directive.

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The AMF also engaged in successful informal cooperation initiatives, responding to requests for assistance from other regulators, notably in emerging countries. This included presenting its model for regulating asset management firms and products to the Brazilian and Indian regulators.

## C – The European Commission's proposal for a directive on alternative investment fund managers

On 1 May 2009 the European Commission published a proposal for a directive on alternative investment fund managers (AIFM), aimed at providing enhanced investor protection and efficient supervision of the systemic risks potentially posed by these funds.

The proposed legislation introduces obligations for managers of alternative investment funds (AIFs), which are defined as all funds that are not harmonised within the meaning of the UCITS Directive, regardless of where they are domiciled. The obligations placed on managers concern their initial authorisation and ongoing supervision by the regulator of the Member State in which they are domiciled, minimum capital requirements, organisational rules, requirements on disclosures to investors and competent authorities (notably as regards the potentially systemic aspects of managed funds), valuation and custody of the assets of managed funds. The proposal covers opportunities for the cross-border management and marketing of AIFs by managers.

The proposal for a directive was prepared following a public consultation on hedge funds held by the European Commission in December 2008, to which the AMF issued a joint response with the Ministry for the Economy and Finance and the Commission Bancaire. The proposed legislation is also consistent with declarations issued by the G20 in April 2009 and with work by IOSCO<sup>39</sup>.

The proposed directive was also the subject of extensive discussions within the European Council during Sweden's presidency, and in the European Parliament, particularly in the Economic and Monetary Affairs Committee, whose rapporteur, MEP Jean-Paul Gauzès, published a report in December 2009 proposing amendments to advance the thinking on the proposals. The AMF made an active contribution to the discussions at European and domestic level, notably in the context of regular dialogue with industry representatives and with the French delegation to the European institutions.

In 2010 the AMF plans to keep up its efforts by continuing to voice its positions on the proposal for a directive, in view of the need to combat financial instability, protect investors but also preserve the competitiveness of France's fund industry. As the European talks currently stand, the AMF's recommendations are focused on:

> clarifying and harmonising the regime for investment fund depositaries: the AMF is recommending a precise definition for the status and tasks of these depositaries (notably on safekeeping for fund assets and supervising manager decisions), and for their obligations and responsibilities (particularly when delegating). To ensure that the harmonisation that the AMF is recommending is complete and benefits all investors in investment funds across the European Union (EU), the AMF is calling for Level 2 measures to be adopted (since the directive alone cannot stipulate individual aspects of the regime applicable to depositaries) and for the regime governing UCITS depositaries to be harmonised through the AIFM Directive. This would mitigate the problems that investors have encountered because of different interpretations of the obligations placed on UCITS depositaries, as highlighted by the Madoff fraud;

> ensuring efficient supervision and monitoring of the systemic risk associated with the activity of AIFs: for this, the AMF recommends giving the European Securities and Markets Authority (the authority that will ultimately replace CESR) strong, permanent powers to request information and intervene on a regular and unannounced basis vis-à-vis competent national authorities and managers, and take binding Level 3 measures to manage identified risks that could threaten the integrity and stability of financial markets. The AMF is also calling for clarification of the mechanisms for exchanging information between national authorities as well as between national and European authorities. In addition, the AMF is recommending that credit institutions and investment firms be required to introduce mechanisms to monitor and supervise leverage associated with the AIFs with which they deal, notably by setting contractual limits on the counterparty risk represented by AIFs both on an individual basis, i.e. by alternative fund, and on an aggregate basis, i.e. by investment strategy;

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<sup>39</sup> International Organization of Securities Commissions

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> enhancing transparency by managers of private equity funds: the AMF is recommending adjusting the proposed directive's transparency obligations for private equity transactions to target managers whose investments are actually likely to generate systemic risk, i.e. leveraged buyouts. The AMF is recommending the adoption of Level 2 measures to precisely define reporting requirements and the prudential monitoring to be conducted by the competent authorities on the potential systemic risk effects of identified transactions;

> limiting passporting arrangements to Europe-domiciled AIFs: unlike the proposed directive, the AMF recommends allowing only AIFs established in the EU to be freely marketed in the EU, in order to protect investors and prevent tax evasion through offshore centres. For the passporting arrangements for European funds to work efficiently, the AMF also feels that the directive should expressly prohibit any use of investment techniques or fund structures (such as funds of funds) that might make it possible to circumvent the restriction of the passport to Europe-domiciled funds. The AMF also recommends adopting Level 2 measures to clarify the requirements for granting and using passports and prevent efforts to circumvent the restriction of the passport to European funds. The AMF's position does not exclude the possibility for individual Member States to permit non-European (i.e. offshore) AIFs to be marketed within their territory under domestic law;

> making the manager responsible for the valuation of AIF portfolio assets, in line with the UCITS model, which is well known and has proven to be effective: from an investor protection perspective, it is essential that valuation (which constitutes a management action) should be under the sole responsibility of the manager (even if delegated) and then subject to supervision and inspection by the depositary. The proposal contained in the draft directive, based on using an independent valuator, raises numerous issues in terms of investor protection and is not appropriate for all types of AIF, such as private equity funds;

> requiring managers to introduce remuneration policies and procedures: the AMF recommends inserting specific provisions in the directive relating to the remuneration of AIFMs. The purpose of these provisions would be to require managers to introduce remuneration policies that are consistent with sound and efficient risk management, while being proportional to the nature, scope and complexity of the managers' activities and the transactions of the funds that they manage.

Unless the initial timetable is changed, the directive is scheduled to be adopted by June 2010 and could come into force in 2012.

## **6 – Developments in market infrastructures**

The AMF worked closely with the other competent regulators and supervisors<sup>40</sup> to review the projects submitted to it in 2009 by the NYSE Euronext, LCH.Clearnet and Euroclear groups, and by ISPs operating multilateral trading facilities (MTFs).

### **A – Activity and regulation of the regulated market operator, Euronext**

In 2009 the regulators of NYSE Euronext discussed and approved one major project, namely the implementation of provisions allowing market members to offer sponsored access to their clients. In addition, following the test phase for the new trading rules covering warrants and certificates, whose new model was validated by the College of Euronext Regulators, NYSE Euronext wanted to improve the model based on test feedback. Regulators were also asked to give their opinion on the appointment of Dominique Cerutti to replace Jean-François Théodore as head of NYSE Euronext.

#### **1 > Sponsored access**

NYSE Euronext wanted to introduce a sponsored access system to allow members' clients to remotely access Euronext markets directly through a special channel, rather than via the member. In practice, the

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<sup>40</sup> The members of the College of Euronext Regulators include Holland's AFM (Authority for the Financial Markets), the AMF, Belgium's CBFA (Commission Bancaire et Financière et des Assurances), Portugal's CMVM (Comissão do Mercado de Valores Mobiliários) and the UK FSA (Financial Services Authority). The Clearing Coordination Committee members, who supervise LCH.Clearnet SA, include the French, Belgian, Dutch and Portuguese regulators, along with the Banque de France, the BNB (Banque Nationale de Belgique), the Bank of Portugal, the Commission Bancaire, CECEI and the DNB (De Nederlandsche Bank). The competent authorities for the LCH.Clearnet group also include the FSA and the Bank of England. The Committee of Competent Authorities for Euroclear includes the Belgian, British, French and Dutch regulators and central banks, as well as the Finnish and Swedish regulators and central banks since end-2008. The Irish regulator and central bank have observer status

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member would have responsibility for orders placed and transactions executed by clients and would be required to introduce an appropriate filter and risk management system. The project was approved in May 2009 by the AMF Board, and afterwards by the College of Euronext Regulators.

## **2 > New functionalities for warrants and certificates**

The test phase for the new market model for warrants and certificates, which began in March, was concluded when the College of Euronext Regulators gave its approval in September 2009. Following this, NYSE Euronext wanted to make improvements to the market's operating rules, both to implement new functionalities based on test feedback and also to prepare for the forecast migration of the warrants and certificates market to the Universal Trading Platform (UTP) in February 2010.

## **3 > Appointment of senior executive**

The appointment of Dominique Cerutti as Chairman of the Managing Board of Euronext N.V., Deputy Chief Executive of NYSE Euronext Inc. and Chairman and CEO of Euronext Paris SA was submitted at end-2009 for the approval of the AMF Board (for Euronext Paris SA) and of the College of Euronext Regulators (for the other appointments). The necessary approvals were granted.

## **4 > Changes to data centres**

NYSE Euronext presented proposals to move its data centres from Aubervilliers in France to Basildon in the UK. The project was examined by the AMF Board on 23 July 2009 and continues to be monitored jointly by the AMF and the ACP.

## **5 > Other modifications**

Another development relating to the regulated market concerned the modification by NYSE Euronext of the operating rules of the Marché Libre and Alternext to reflect the effects of reforms to the framework for public offers of securities. In the case of Alternext, an amendment was made in June 2009 and came into force following the publication of the Order of 4 November 2009 amending the AMF General Regulation. The amendment allows companies admitted to trading on the Eurolist compartment of the regulated market to be transferred to Alternext.

# **B – Multilateral trading facilities**

## **1 > Bluenext Derivatives**

Bluenext Derivatives is a futures market for the trading of two futures contracts in CO2 emission quotas (European Union Allowances (EUAs) and Certified Emission Reduction credits (CERs)), with different annual expiries through to 2012. In March 2009, Bluenext submitted a proposal for an amendment to its operating rules to the AMF Board. The purpose of the modification was to introduce trading strategies to either exploit price spreads between CER and EUA futures by simultaneously buying and selling contracts<sup>41</sup> or to simultaneously buy (or sell) all available expiries of a contract<sup>42</sup>. The Board approved the modification of these rules.

## **2 > Alternativa**

Alternativa, the MTF operated by AM France, offers small and medium-sized companies a trading solution for their securities. In June 2009 Alternativa created a new market segment to make it possible to calculate the execution price on the secondary market for shares in real estate investment companies (SCPIs). Article 321-44 of the AMF General Regulation was amended at the same time to enable SCPI management companies to outsource the task of calculating execution prices to an MTF or regulated market.

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<sup>41</sup> Intercontract spread strategy

<sup>42</sup> Strip strategy

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## C – Clearing activity and regulation

### 1 > Activity and regulation of LCH.Clearnet SA, the clearing house

LCH.Clearnet SA submitted three projects to the AMF Board in 2009. The first of these concerned reorganising the ownership of the holding company of the LCH.Clearnet group. The other two projects involved new clearing services for the SecFinex lending/borrowing platform and for European credit default swaps (CDS). LCH.Clearnet SA also submitted various amendments to its operating rules to the Board.

#### a) Reorganising the ownership of LCH.Clearnet Group

The management of the LCH.Clearnet group took steps to reorganise the ownership of LCH.Clearnet Group Ltd, the group holding company, to strengthen the shareholdings of users of group services. As part of this, LCH.Clearnet Group acquired the shares of shareholders who wanted to sell their interests, giving priority to shareholders making little or no use of group services. Major users of group services increased their interest considerably as a result, from 37% to 63%. The group is now 73% owned by user members and 17% by the exchanges that have a clearing agreement with it. Also, Euroclear Bank sold its shareholding.

#### b) SecFinex clearing services

In June 2009 the AMF Board approved LCH.Clearnet SA's proposal to offer clearing services to SecFinex, a securities lending/borrowing platform, as well as the corresponding amendments to the clearing house's rules. LCH.Clearnet SA's services cover trades in European securities listed on Euronext. The risk management arrangements put in place by the clearing house are identical to those used for the clearing of NYSE Euronext's European cash markets.

#### c) Amendments to operating rules

The Board also approved a series of amendments to the clearing house's operating rules. This included a change to the structure of the operating rules, which are now organised by theme rather than by market, to make them clearer. The clearing house also clarified its member default management procedures as well as the extent of its liability to its members.

#### d) Clearing services for European CDS

In December 2009 LCH.Clearnet SA submitted to the AMF Board a proposal to offer clearing services for CDS on European indices, as well as the corresponding operating rules. LCH.Clearnet SA indicated that it would receive trade flows from the trade information warehouse managed by the Depository Trust and Clearing Corporation and perform novation on a daily basis. A dedicated mutualised clearing fund would be set up. In addition, given the specific nature of this activity, the clearing house created special operating rules separate from those applicable to the other segments already cleared by LCH.Clearnet SA. The project was assessed with respect to the ESCB-CESR recommendations for central counterparties, a process coordinated by the Banque de France with the aid of the other competent authorities responsible for the clearing house. Based on this assessment, the authorities asked the clearing house to more effectively document and clarify certain aspects of the system, particularly in the area of risk management. The AMF Board approved the project and the corresponding rule changes, provided that LCH.Clearnet SA implemented the measures recommended by the authorities. LCH.Clearnet SA plans to launch the project on the market in March 2010. The project forms part of the strategy of regulating OTC derivatives drawn up following the financial crisis.

### 2 > Work by IOSCO on clearing houses

At the joint initiative of CPSS and IOSCO's Technical Committee, a review of the November 2004 recommendations for central counterparties was initiated in mid-2009 to assess the need for adjustments or additional measures to reflect the specific nature of central clearing for OTC derivatives, notably in terms of risk management, governance and transparency. Discussions were held to come up with a preliminary assessment, pending legislative developments in the US and Europe, of the elements to be taken into account by competent authorities to regulate and supervise trade repositories, or trade information warehouses, for derivatives. After a consultation in spring 2010, the reassessment of the recommendations for OTC derivatives clearing and aspects relating to trade repositories should be

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incorporated into the broader review of CPSS-IOSCO recommendations for payment systems, central counterparties and securities settlement systems scheduled for the end of 2010.

### **3 > Work within Europe on clearing credit derivatives**

The financial crisis exposed a number of issues on OTC derivatives markets, particularly in credit derivatives such as credit default swaps (CDS). Since the statements issued by the G20 in September 2009, CDS clearing has been the subject of work in both the USA and Europe.

The AMF welcomes the European Commission's proposals on passing legislation in the area of OTC derivatives. In particular, it supports the principle of Community legislation governing the activities of clearing houses and trade repositories and requiring these infrastructures to be authorised.

Furthermore, to the extent that a large share of OTC derivatives is denominated in euros and is on the balance sheets of euro area financial institutions, it seems necessary that at least one clearing house clearing OTC-traded derivatives – particularly euro credit derivatives – should be located, regulated and supervised in the euro area and that there should also be a trade repository in the euro area. The events of the first quarter of 2010 in connection with sovereign CDS underscored once again the vital need to make OTC derivatives markets transparent, especially to regulators.

This situation increases the importance of the European Commission's existing plans for a mandatory trade repository for OTC derivatives. Regulators should have unrestricted access to the data in the repository. Given the crucial role played by these entities in reducing systemic risk and ensuring adequate supervision of activity in standardised derivatives, there is no reason to limit the scope of these infrastructures to credit derivatives.

#### **D – Activity and regulation of Euroclear France, the securities settlement system operator and central depository**

In November 2008 the Euroclear group acquired the Finnish and Swedish central depositories. The competent authorities for those entities thus joined the committee of Euroclear group authorities and signed the memorandum of understanding (MoU) that organises cooperation between these authorities. This cooperation concerns the supervision of the Belgian financial holding company Euroclear SA in its capacity as holding company supplying technical and support services to the central depositories of the group, including Euroclear France. When the group of signatories was widened, the MoU was slightly modified, chiefly to update the regulatory references and add a confidentiality clause. The AMF Board approved these changes in April 2009.

The AMF Board approved the appointment of Valérie Urbain to the position of Chief Executive Officer of Euroclear France, seeing no reason to object to the appointment.

The AMF Board also approved various amendments to the operating rules of Euroclear France and the ESES France settlement system. The changes consisted notably in modifying the rules to reflect legal and regulatory developments, including the introduction of the concept of financial securities (*titres financiers*) following reforms to securities legislation, and the review of the provisions relating to institutions that may become members of Euroclear France or participants in ESES France, following publication of the Executive Order of 8 January 2009.

Euroclear France also eliminated its "local securities record" system. This was a separate module of the ESES France settlement sub-system in which settlement finality was recorded. The rules of the ESES France system were modified accordingly.

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## **7 – Work by the consultative commissions and cross-industry groups on markets and exchanges and clearing, custody and securities settlement**

### **A – Work by the consultative commissions**

#### **1 > Consultative Commission on Markets and Exchanges**

Composition :

Jean-Michel Naulot, Chairman

Jean-Pierre Pinatton, Vice Chairman

Jean-François Bay (Seeds Finance SA), Jean-François Biard (BNP Paribas), Françoise Bonfante (UBS Securities France SA), Jean-Pierre Bornet (Banque Fédérale des Banques Populaires), Alban Caillemer du Ferrage (Gide Loyrette Nouel), Laurent Clamagirand (AXA – Group Management Services), Didier Demeestere (Talence Gestion), William Higgons (Siparex), Catherine Langlais (Euronext), Jean-Bernard Laumet (HSBC Securities), Patrice Marteau (Acteo), Hubert Massiet du Biest (LCL Crédit Lyonnais), Jean-Pierre Mattout (Cabinet Kramer Levin), Alain Moynot (SCS Almo Finances), Christian Nesi (Banque de France), Bertrand Patillet (CA Cheuvreux SA), Jacques Saintavit (Crédit Agricole SA), Hubert de Vauplane (Crédit Agricole).

The Consultative Commission on Markets and Exchanges met seven times in 2009.

The commission was asked to look at consultation papers published by CESR over the course of the year to give an additional opinion to the individual responses sent directly to CESR. Among other things, the commission was asked to give an opinion on CESR's consultation papers on the classification of complex and non-complex products under MiFID, on the scope of investment advice and on application of the framework for inducements and good and bad practices in this regard. The commission was also invited to provide guidance on post-trade transparency for non-equity financial instruments as part of work by CESR on a possible extension of the post-trade transparency rules.

Ahead of the MiFID review, the commission was invited to take part in a preliminary discussion on the broad guidelines that should shape the process, particularly regarding MiFID provisions on the organisation of equity markets.

Two progress review sessions were held during the year on the European Commission's proposal for an AIFM Directive dated 29 April 2009. These sessions covered the main elements of the debate and progress in the discussions. The commission was similarly kept abreast of work on the same issues by the task force on unregulated entities set up by IOSCO's Technical Committee. The commission was also asked to give an opinion on the European Commission's October 2009 communication on the regulation of OTC derivatives markets.

On issues more directly related to French markets, the commission was asked to provide an opinion on a draft amendment to the AMF General Regulation on major shareholdings and statements of intent, and was also consulted on the draft Q&A to clarify the requirements governing trading by ISPs during an offer.

The commission was additionally asked for an opinion before the AMF held its consultation in spring 2009 on the short selling regime, based on the findings of the working group led by Marie-Ange Debon and Jean-Pierre Hellebuyck. The commission also gave a negative opinion on the sponsored access proposals put forward by Euronext.

#### **2 > Consultative Commission on Clearing, Custody and Securities Settlement**

Composition:

Dominique Hoenn, Chairman

Jean de Demandolx Dedons, Vice Chairman

Jacques Aschehoug (L'Oréal), Robert Baconnier (ANSA), Philippe Castelanelli (HSBC Bank Plc), Emmanuel de Fournoux (AMAFI), Michel Germain (Professor, Paris-II University), Christophe Hémon (LCH.Clearnet SA), Anne Landier-Juglar (CACEIS), Philippe Langlet (Société Générale), Christophe Lepitre (OFI), Yvon Lucas (Banque de France), Guy Mengin (Crédit Suisse), Daniel Mesure (Crédit Agricole Titres), Marcel Roncin (AFTI), Yann de Saint-Meleux (Euroland Consulting), Valérie Urbain (Euroclear).

The commission met three times in 2009.

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The commission was involved in preparing the AMF's response to the European Commission's consultation in spring 2009 on "Legislation on Legal Certainty of Securities Holding and Dispositions". The commission endorsed not only the principle of responding positively to the European Commission's proposals, to promote convergence in Europe's securities laws, but also the notion that the response should underline the drawbacks of a "functional" analysis based on minimum harmonisation that would enable any investor to be able at least to exercise the voting rights attached to securities, which is the cornerstone of the European Commission's approach.

On issues relating to the French market, the commission issued opinions on two draft amendments to the AMF General Regulation. The first was designed to take account of technical changes to settlement systems in recent years (systematic application of the principle of continuous final settlement). The second came about following an amendment to the Monetary and Financial Code and concerned the requirements for becoming a member of a central depository or a participant in a settlement system.

The commission was also asked to provide opinions on a number of technical questions. The first concerned deadlines for the review of responses to corporate actions. The commission proposed setting a single mandatory deadline for submitting responses to a corporate action to the transfer agent. The second question concerned work on fund administration. AMF staff outlined proposed regulations for fund administration after conducting work in recent months with AFTI, AFG and Euroclear France. They also presented the legal issues raised by this work. Furthermore, the commission conducted a progress review on implementation of the procedures for identifying CIS shareholders/unitholders.

## B – Work by the cross-industry groups on markets and exchanges

Like the regulators of the other main financial centres, the AMF adopted a series of exceptional measures on 19 September 2008 aimed at preventing short selling in listed financial stocks.

On 6 November 2008 the AMF announced that it was setting up a cross-industry group led by Marie-Ange Debon and Jean-Pierre Hellebuyck to propose to the Board a permanent regulatory framework for short selling that could be introduced once the exceptional measures ran out.

Based on the findings of the working group, which published its report on 23 February 2009, the Board held a consultation, making the following key proposals:

- > it would be neither realistic nor advisable to attempt to ban short selling systematically, but the practice should be regulated; in particular, any person placing an order for a short sale must make the necessary arrangements to be able to deliver the securities within the standard settlement cycle (T+3);
- > any seller that is unable to deliver the securities within the standard cycle should be subject to harsher penalties than those currently applicable;
- > market transparency could be provided by publishing net short positions exceeding a defined threshold, such as 0.25% of the capital of a listed company; as a supplemental measure, investors could be required to inform their intermediary whether the order they are placing is for a short sale, thus allowing the regulator to disseminate aggregate information to the market;
- > short sellers should be required to declare to the regulator the volumes and prices of securities loans, so that the regulator is alerted in good time to possible pressures in the securities lending market.

The report made the point that since some of the recommended measures would not be fully effective unless agreed upon by regulators in the main financial centres, the AMF would make every effort to secure such an agreement.

It was against this backdrop that the AMF took part in work on this issue over the course of 2009 within IOSCO and especially CESR.

Accordingly, when the consultation that began on 23 February 2009 was concluded, the AMF decided to wait for the findings of CESR's work before adopting the definitive arrangements for France and to maintain the exceptional regime introduced in September 2008 at least until January 2010<sup>43</sup>.

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<sup>43</sup> A news release published on 27 January 2010 on the AMF website ([www.amf-france.org](http://www.amf-france.org)) under News Releases announced that the regime would be maintained until further notice

## **8 – International cooperation on market intermediaries and infrastructures**

### **A – Work by IOSCO (SC2) and CESR on markets**

#### **1 > Work by IOSCO's standing committee on the regulation of secondary markets (SC2)**

Following a public consultation, SC2 finalised its report on outsourcing by regulated markets. The report sets out the principles governing the conditions under which regulated markets may be authorised to entrust some of their activities to third parties, whether regulated or not.

As part of its work on transparency in the secondary market for structured products, SC2 published a consultative draft report in September that invited competent authorities to examine how post-trade transparency could be strengthened in their jurisdiction. Responses to the consultation revealed a shared vision on the benefits of greater transparency in these markets.

After a close examination of all the feedback, SC2 should be in a position to propose a final report for the approval of the Technical Committee in the first quarter of 2010.

In spring 2009, SC2 began a new round of discussions on the issues raised by dark liquidity, which encompasses trading systems operating without pre-trade transparency and fully hidden orders on "transparent" platforms. These issues concern in particular the impact of dark liquidity on the price discovery mechanism, market fragmentation, fair access to liquidity, information leakage through indications of interest and the exact measurements of dark trading volumes. SC2 will consider to what extent principles could be formulated to assist regulators in answering these questions.

Finally, although the initial report of the Task Force on Unregulated Products and Markets is mainly centred on securitisation and CDS, in 2010 SC2 will consider whether the recommendations contained in the report could be applied to other OTC derivatives.

#### **2 > Work by CESR**

##### **a) MiFID markets sub-group**

The MiFID markets sub-group devoted much of its time to analysing the impact of MiFID on secondary equity markets in Europe, two years on from its entry into force. This work led to the publication by CESR of a report in June 2009 that recommended three main areas of focus for the forthcoming MiFID review: pre-trade transparency and the trade-off between an efficient price formation mechanism and the need for waivers for certain types of transactions to prevent harmful market impact; improving the quality and accessibility of post-trade data; and reassessing the regulatory frontiers between different order execution modes and venues to maintain a level playing field and so promote market efficiency and integrity.

In September 2009 the working group began discussions on these three aspects, factoring in the impact of technological developments, such as high-frequency trading, so that CESR could provide recommendations for the European Commission to use in the review of MiFID in July 2010.

The work of the group on non-equity transparency gave rise to the publication of another report by CESR in July 2009. Following an in-depth analysis of the benefits and possible drawbacks of increased post-trade transparency for corporate bonds, securitisation instruments and CDOs, the report came out in favour of greater post-trade transparency for corporate bonds admitted to trading on a regulated market or MTF, while stressing the need for a carefully-calibrated approach to transparency to avoid any adverse effects on market liquidity. Regarding asset-backed securities (ABS) and collateralised debt obligations (CDOs), the report recommended gradually applying post-trade transparency to all ABS that are generally considered to be standardised. The report also recommended post-trade transparency for CDS that are eligible for central counterparty clearing by virtue of their standardisation. As part of the MiFID review, and at the request of the European Commission, the group will prepare more precise and practical proposals for these various areas.

The working group also contributed actively to the prior consultation procedure introduced by CESR in early 2009 for pre-trade transparency waiver applications submitted by a regulated market or MTF to its competent authority. CESR webposts its assessments of the compliance of these requests with MiFID and its implementing regulation<sup>44</sup>.

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<sup>44</sup> [www.cesr.eu](http://www.cesr.eu).

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## **b) Work by CESR on clearing and settlement**

After several years, the recommendations prepared jointly by the European System of Central Banks (ESCB) and CESR on central counterparties and settlement systems in the EU were adopted in June 2009. These recommendations, which are aimed at the regulators and supervisors of these post-trade infrastructures, modify the CPSS-IOSCO recommendations to suit the European framework. They seek to make Europe's post-trade systems more efficient, secure and sound, while promoting the integration of European financial markets.

The recommendations form a common frame of reference that competent authorities agree to use in regulating and supervising clearing houses, securities settlement systems and central securities depositories. They accommodate the peculiarities of clearing for OTC derivatives, particularly in terms of risk management, governance and transparency.

CESR's Post-Trading Expert Group (PTEG) continued to dialogue with the European Central Bank (ECB) on the requirements for establishing the Target 2 Securities (T2S) platform and the system's interaction with the powers assigned to national authorities to supervise domestic settlement systems.

In 2009 the third part of the code of conduct for clearing and settlement, which deals with services unbundling and accounting separation, took effect for the first time. In accordance with the terms of reference agreed between the European Commission and the code's signatories, CESR sent a summary of the documents received under the third part of the code to the Monitoring Group set up by the European Commission to monitor proper implementation of the code. In an advice submitted to the European Commission in March 2009, however, CESR emphasised the code's limitations in terms of facilitating competition and interoperability between clearing houses, given the diversity of domestic laws, and indicated that overall it was felt that only a European legislative initiative would be likely to promote a single post-trade market.

The European Commission's communication of 26 October 2009 was therefore well received.

Furthermore, PTEG took the initiative to launch a debate on creating one or more trade repositories in Europe in a consultation paper published at the end of September 2009.

## **B – Work by IOSCO (SC3) and CESR on market intermediaries**

### **1 > SC3, IOSCO's standing committee on the regulation of market intermediaries, concentrated on the following subjects**

#### **a) Risk management and prudential supervision**

Responding to a request that came out of work by the task force on the subprime crisis, SC3 continued to examine:

- > the internal control systems of financial intermediaries, including asset management companies;
- > liquidity risk management: SC3 has been asked to contribute to work by the Basel Committee on liquidity risk management. The committee is examining the issue from the specific angle of market liquidity (identification of methods for valuing financial instruments and calculating haircuts, classification of financial instruments and major risks observed during the crisis, etc.).

SC3 will present its report on liquidity risk management practices and internal controls to the Technical Committee in mid-2010.

#### **b) Requirement to verify the suitability or appropriateness of complex financial products**

This mandate addresses one of the recommendations issued by the IOSCO task force on unregulated products and markets. It covers the distribution of complex financial products in sales with or without advice and includes a stocktaking of definitions and client classifications (retail/professional) in different countries. A survey of applicable regulations was carried out to see whether some or all complex products could be automatically considered as inappropriate for retail clients in certain countries. The survey included a section on how suitability rules worked in practice during the crisis and the lessons that regulators learned from this. The survey phase will be supplemented with a review of the existing international principles to identify areas that need to be strengthened.

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### **c) Protecting client assets when an intermediary fails**

In light of the events following the collapse of Lehman Brothers, in June 2009 the Technical Committee approved a mandate for SC3 to conduct work aimed at gaining a better understanding of the effects of an intermediary's failure in countries represented on the committee. To carry out this project, SC3 is conducting a stocktaking of the frameworks in place in different countries to protect assets in the event of failure. The survey does not cover the general legal framework for bankruptcy except where, and insofar as, this is necessary to understand the regime that governs intermediaries. This work takes account of initiatives by other working groups, including the one set up by the Basel Committee.

#### **2 > Work by CESR on MiFID application by ISPs**

The MiFID intermediaries sub-group continued its work aimed at promoting convergence in practices across Europe.

As regards regulators' practices, feedback from CESR members in response to a questionnaire was used to assess implementation of the protocols on ISP passport notifications and on supervision of ISP branches.

As regards ISP practices, a questionnaire sent out in late 2008 was used to gain a better understanding of how ISPs were applying the inducements regime (which covers commission rebates in particular). Based on the feedback, a document reviewing the situation and proposing good and bad practices was put out to public consultation in October 2009. The definitive proposals, which will take account of the responses to the consultation, are scheduled to be made public at the end of the first quarter of 2010.

CESR consulted on the scope of investment advice, the new investment service introduced by MiFID. Although CESR's proposals are consistent with positions published by the AMF, a number of questions remain concerning the precise scope of advice. CESR is expected to publish final positions at the end of the first quarter of 2010.

CESR also held a consultation on the difference between complex and non-complex products under MiFID. The consultation paper emphasised a number of shortcomings in the directive. CESR released its final positions on interpreting the current provisions in November 2009.

At the end of the year, work began on the MiFID review. A consultation paper is scheduled to be published in spring 2010. It will contain a series of proposed amendments to the directive, covering areas such as the definition of complex and non-complex products (following the work mentioned above), the regime for tied agents, obligations in terms of safeguarding clients' assets (in the wake of the Lehman failure) and information about execution quality on different markets. An overall review of the best execution regime will also be carried out as part of this. To this end, a questionnaire was sent out to a sample of ISPs.

The consultation paper on the MiFID review will also tackle the question of whether to maintain certain options allowed under the directive, including the option of having a national framework for the recording of orders received by telephone, in an effort to foster greater convergence of national regimes.

### **C – Work by IOSCO on commodity derivatives markets**

Based on the positions set out by the G20 in Pittsburgh, IOSCO's Technical Committee decided in late 2009 to entrust a new mandate to the task force on commodity futures markets, which had published an initial report in March 2009. The task force is now being asked to promote implementation of the recommendations contained in the report, with a focus on energy markets.

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## **9 – Professional certification of market participants' regulatory knowledge – creation of the Financial Skills Certification Board and introduction of the certification system**

The AMF General Regulation was amended to establish a system to certify the regulatory knowledge of market participants, and the AMF set up a ten-member Financial Skills Certification Board (FSCB). The members of the FSCB appointed AMF Board member Jean Pierre Pinatton as chairman. To support its work, the FSCB is assisted by an operational committee made up of experts in regulatory training and professional examinations.

Employees in key posts – trader, salesman, investment analyst, asset manager, head of clearing and post-trade services, compliance officers – are required to comply with the knowledge verification framework.

Based on the FSCB's work, the AMF published on 17 July 2009:

> the content of the minimum body of knowledge that participants have to acquire (scope, weightings assigned to topics based on importance, etc.);

> requirements for exams to be certified;

> a set of Q&A on implementing the knowledge verification framework.

The AMF received the first requests to certify exams in November 2009.

The obligation for ISPs to verify professional knowledge will come into force on 1 July 2010.

### **Composition of the Financial Skills Certification Board**

#### **Chairman**

Jean-Pierre Pinatton, AMF Board member

#### **Members**

> Vincent Bazi, certified investment analyst, head of equity management, Nextstage SAS

> Frédéric Bompaire, Vice President, BFT Gestion, a Crédit Agricole Group asset management company

> Alain Closier, Head of Securities, Société Générale Securities Services

> Denis Dubois, Professor, CNAM

> Jean-Luc Enguehard, Chairman, Banque Postale Asset Management

> Michel Fleuriet, Former Chairman, HSBC France, Professor, Paris-Dauphine University

> Christian Hodara, Compliance Officer, Goldman Sachs

> Vivien Levy Garboua, Head of Compliance and Internal Control Coordinator, Member of the Executive Committee, BNP Paribas