AUTORITÉ
DES MARCHÉS FINANCIERS

AMF position - recommendation
A guide to regulatory documents governing collective investments schemes and real estate funds – DOC-2011-05

Background regulations: Article 78 of directive 2009/65/EC dated 13 July 2009, European regulation 583/2010 of 1 July 2010 and Articles 411-106 to 411-120 of the AMF General Regulation.

The positions and recommendations presented in this guide are in line with the doctrine already published or applied by the *Autorité des Marchés Financiers* as part of the examination of the individual approval files.

Unless recommendations are specifically identified as such, the doctrinal elements contained in this guide are positions.

Lastly, this guide does not aim at compiling all the applicable rules, positions and recommendations governing the drafting of regulatory documents for collective investments schemes (CISs) and real estate funds. It is the duty of the asset management companies to identify these rules in the applicable regulations and make sure that they are complied with.

General information

Approving a CIS or a real estate fund and, where appropriate, each of its compartments, is contingent upon prior filing with the *Autorité des Marchés Financiers* of a file containing the elements provided for in the following instructions of the *Autorité des Marchés Financiers*: instructions 2011-19 and 2011-20 for collective investment schemes (CISs), instruction 2011-21 for employee savings funds, instruction 2011-22 for authorised private equity funds, innovation funds and local investment funds and instruction 2011-23 for real estate funds. For CISs and real estate funds created as of July 1, 2011, the incorporation documents are the following:
- The Key Investor Information Document (KIID), replacing the simplified prospectus or information note;
- The prospectus[1], including the Regulations of the fund or articles of incorporation of the open-ended investment company (or open-end real estate investment companies).

The content of the KIID and that of the prospectus are distinct:

- The prospectus describes precisely the investment and operating rules of the CIS or real estate fund.
- The KIID provides the information needed for investment decision making. It shall be articulated and worded in such a way as to be easily understood by investors and it must provide clear and transparent information which allows investors to make their investment decision in full knowledge.

The Key Investor Information Document (KIID)

Directive 2009/65/EC dated 13 July 2009 provides for articulating a document entitled "Key investor information" which replaces the current simplified prospectus for UCITS. European regulation 583/2010 dated 1 July 2010 defines the content of this document.

However, in order to help non-professional investors compare the different CISs and real estate funds marketed in France, either UCITS or non-UCITS, it was decided as part of the work undertaken by the Financial Services High Level Committee to expand the introduction of this document to all CISs and real estate funds accessible to the general public, i.e. all generalist CISs (either UCITS or non-UCITS), alternative funds of funds, employee savings funds (FCPE/SICAVAS), real estate funds sold to retail investors, real estate funds with streamlined investment rules and without a leverage effect (OPCI RFA sans effet de levier) and authorised private equity funds (private equity funds - FCPR, innovation funds – FCPI and local investment funds - FIP).

Conversely, CISs and real estate funds reserved for specific investors such as contractual CISs reserved for specific investors, fast-track funds, approved CISs reserved for specific investors (ARIA), real estate funds with streamlined investment rules and with a leverage effect (OPCI RFA avec effet de levier) and private equity funds reserved for specific investors (fast-tracks funds or contractual private equity funds) do not fall under the scope of the KIID. The only regulatory documents are the following:

- For contractual CISs reserved for specific investors (ARIA funds with streamlined investment rules) and real estate funds with streamlined operating rules and with a leverage effect (OPCI RFA) : the prospectus (including the Regulations or articles of incorporation);
- For private equity funds reserved for specific investors (fast-track funds or contractual funds) : the Regulations;
- For CISs reserved for specific investors (subject to less stringent approval procedures): the note and the Regulations or articles of incorporation.

CISs or real estate funds are required to release, on a regular basis, the information contained in the KIID. The information must be transparent, clear and non-misleading. To this view, this guide:

- presents several templates for articulating a KIID as soon as it concerns UCITS or non-UCITS, taking into account the characteristics of the different CISs and real estate funds concerned;
- recalls some applicable rules;

[1] Except for employee savings fund s and private equity funds

- sets out positions and recommendations for applying these rules;
- illustrates these rules, positions and recommendations[2] by some examples.

Besides, it is recalled that incorporating a CIS or a real estate fund (or a compartment of a CIS or real estate fund) is subject to prior approval by the *Autorité des Marchés Financiers*. The AMF approves the CIS or real estate fund on the basis of the fund's Regulations (or articles of incorporation for open-end investment companies/open-end real estate investment companies) and of the information provided to investors, in particular in the KIID. The asset management company is solely liable for the information provided to investors in its documents. Accordingly, the asset management cannot possibly present these documents as being approved by the *Autorité des Marchés Financiers*.

1.1. KIID for UCITS

1.1.1. Texts and principles

The following texts are applicable as a whole:

- ➢ European directive: directive 2009/65/EC dated 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to UCITS
- ➢ European regulation: regulation 583/2010 dated 1 July 2010
- ➢ CESR Level 3 Guidelines on the methodology for the calculation of the synthetic risk and reward indicator (CESR/10-673)[3] , on the performance scenarios for structured UCITS (CESR/10-1318), on the methodology for calculating the ongoing charges figure (CESR/ 10-674), on the CESR's guide to clear language and layout for the KIID (CESR/10-1320), and on the CESR's template for the KIID (CESR 10-1321)

This guide does not include all the European provisions defined in the aforementioned regulations. All relevant actors shall refer to this guide to be aware of these rules and apply them.

1.1.2. Headings pertaining to the presentation of the KIID

1.1.2.1. Name of the CIS

The name of the CIS shall not use terms with a regulatory or common meaning which would not suit the profile of the CIS.

Using the term "guaranteed" for a CIS which bears a risk of capital loss is inappropriate, and so is the use of the term "safe" for a CIS likely to expose more than 30% of its net assets under management to risky assets such as equities, high yield bonds or any other type of assets that could help the CIS achieve high performance
More generally, depending on the type of investors to whom the CIS is marketed, using terms referring to the preservation of the capital and / or to a regular increase of the net asset value (such as "serenity", "safety", etc…) is not suitable when it comes to naming a CIS the net asset value of which is likely to deviate from that of a fund invested in monetary assets, except when the capital of the said CIS is totally guaranteed.

1.1.2.2. Investment objective

The investment objective shall be understandable without reading the rest of the KIID and it shall help investors identify the main purpose and characteristics of the investment policy implemented by the CIS. Naturally, it shall be consistent with the investment policy, the reference indicator (where appropriate), and more generally, with the technical and financial characteristics of the CIS.

[2] In order better to identify them, good and bad practices are written in italics
[3] The exact references of the CESR documents will be updated

Wording the investment objective

- The investment objective must be clearly described and avoid general wording like *“achieving capital appreciation”*, since this wording fails to give enough information on the risk and reward profile targeted by the fund. Wording like *“achieving capital appreciation”* is accepted when the investment policy presents clearly and precisely the risk/reward profile of the CIS.
- The investment objective shall avoid imprecise wording of the performance objective set by the CIS, which would prevent investors from assessing accurately the performance of the fund.
  For instance, where the risk-reward profile, net of all expenses, does not allow anticipating a given performance (for instance: EONIA), asset management companies shall avoid wordings like *“the fund will look to achieve a performance ‘similar’, ‘close’ or ‘equivalent to the EONIA’”* and shall instead write *“the fund will look to achieve a performance equal to the EONIA, minus management costs […]”*.
- The description of the investment objective shall also clearly identify the name of the potential benchmark indicator. It cannot restrict itself to referring to it.

Accordingly, wordings like *“the CIS will seek to outperform its benchmark index […]”* shall be avoided and one may rather choose a wording like *“the CIS will seek to outperform the CAC 40 index […].”*

When the benchmark indicator is a debt security and when the CIS aims to replicate the performance of this security or to outperform it over a given time period, describing the debt security’s characteristics which makes it identifiable shall include most of the time the denomination per unit of the bonds when first issued, while the actual return on the bond, given its purchase price when the fund was first launched, may strongly differ. In order to avoid that the information disseminated be misleading, mentioning the nominal rate alone shall be avoided and it shall always be supplemented with the actuarial rate of return on the bond.

- The investment objective shall be worded in a very synthetic way. However, it may be needed to outline, in some cases, the investment strategy or the asset classes representative of the fund’s investment universe if these elements makes the fund’s investment objective clearer and help understand it better.

Recommendation:
When a CIS implements a systematic investment strategy using a mathematical model, the *Autorité des Marchés Financiers* recommends mentioning this characteristic in the investment objective

Consistency of the investment objective

- The investment objective must be consistent with the investment strategy implemented by the fund to reach the said objective.
  For instance, if the risk/reward profile of a CIS is different from that of the money market, the fund’s investment objective shall not mention that the capital invested is safe.

  Indeed, when a CIS seeks to have its investors reap the benefits of a return higher than the money market risk-free rate through additional sources of return compared to the safest money market instruments, it shall not indicate an investment objective that aims to preserve the capital, insofar as it does not reveal the risks the fund is confronted with.

- The investment objective shall be consistent with the investment strategy implemented and compatible with the cost levels indicated. Money market funds with a total expense ratio (TER) of 1% shall not aim to outperform the EONIA index.

- Consistency of information, which is a requirement, applies to feeder CISs that charge additional fees to those charged by the master fund. Accordingly, the investment objective shall stipulate the fees charged by the feeder fund, even when the master fund sets a quantitative performance objective. For instance, when a master fund sets a quantitative performance objective of 7% over the recommended investment period, the feeder fund, the TER of which stands at 0.5%, cannot possibly mention a performance objective of 7% itself. The *Autorité des Marchés Financiers*, in this case, requires that the feeder fund mention a performance objective of 6.5%. However, this requires the asset management company to check in advance that the characteristics of the feeder fund are not liable to make the investment objective unrealistic.

- This consistency requirement also applies to CISs which set a quantitative performance objective by offering several classes of units or shares which incur different management fees.

- For instance, a CIS which seeks to yield a return equal to the EONIA plus 2% and which proposes two classes of units or shares :
  - a unit or share I for which maximum management fees are 0.60% of the net assets
  - and a unit or share R for which maximum management fees are 1% of the net assets
  can set the following investment objective:
  "The investment objective is to achieve an annual performance equal to the EONIA plus 1.40% for units I and to the EONIA plus 1% for units R over a minimum recommended investment period of x years"

Classification of the CIS

The classification shall be indicated in the section "Investment objective and policy" of the KIID.

Pursuant to articles 30-09 of instructions 2011-19, 2011-20 and 2011-21, the classification "diversified" regroups all those CISs which do not fall under the scope of another category. A CIS may be classified as "diversified" only when the exposure limits of the said CIS provided for in the KIID do not satisfy the limits provided for in articles 30 et seq of instructions 2011-19, 2011-20 et 2011-21 on the classifications.

For instance, a CIS that mentions exposure ranges from 0% to 40% to the bond market and from 60% to 100% to the equity market of the euro zone can by no means be classified as "diversified" insofar as it meets the criteria provided for in the articles 30-2 of instructions 2011-19, 2011-20 and 2011-21 on the classification of the "euro zone equities".

1.1.2.3. Investment policy

The investment policy lays out the management principles implemented by the CIS succinctly. It shall focus on presenting the information that will help potential investors in the fund understand how the fund looks to achieve the investment objective. Accordingly, the information on the investment policy implemented must be presented to investors in an understandable manner.

When the fund is aimed at non-professional investors, technical terms or terms belonging to the jargon of the financial industry shall be avoided. This also applies when the CIS is subscribed by an insurance company and distributed to non-professional investors through unit-linked life insurance contracts.

It bears reminding that it is neither possible nor relevant to make an exhaustive list of the assets used in the KIID. This piece of information shall instead appear in the prospectus.

General presentation of the investment policy

The investment policy shall focus on explaining the targeted risk/reward profile and on the management strategies.

The prospectus describes, in turn, the financial techniques for determining the fund's risk/reward profile.
When the CIS is invested in certain specific markets but uses financial techniques (derivatives, securities lending and borrowing, etc…) to modify its exposure to these markets, the document shall present the consolidated exposure resulting from these changes.

Similarly, when a CIS invested in the equity markets reserves the right to hedge totally the equity risk through financial contracts, the *Autorité des Marchés Financiers* requires that the fund's strategy for exposure to the equity markets be presented in a consolidated form, taking into account both its exposure arising from the direct purchase of equities and its other exposure or hedging strategies.

When the investment strategy implemented upon the launch of the fund is different from that to be implemented at maturity, the investment policy must highlight this situation and describe the strategies implemented successively.

<u>The investment policy for a CIS eligible to an equity savings scheme</u>

For CISs eligible to an equity savings scheme - i.e. CISs which invest at least 75% of their assets in equities eligible to an equity savings scheme - and which use derivatives to trade their exposure to the European community markets for an exposure to other markets (Asian markets, bond markets, etc…), the *Autorité des Marchés Financiers* requires that the resulting investment strategy be presented in a consolidated form and that information relating to investment in securities eligible to the equity savings scheme be given at the end of the related section or in the prospectus only.
Conversely, presentations of the investment strategy which first mentions that the CIS will be invested at up to 75% in securities eligible to the equity savings scheme but that it will use financial futures instruments to trade the performance of these securities for the performance of securities to which it is exposed[4] shall be avoided.

A CIS which is eligible to an equity savings scheme but which uses derivatives to gain exposure to US equities will be required to first highlight its exposure to the American markets and its equity selection strategy on these markets and, only afterwards, its investment in European equities. It bears noting that these provisions do not preclude that information on the fund being eligible for the equity savings scheme be mentioned at the head of the section pertaining to the investment strategy, should this information be of material importance to investors at whom the fund is aimed.

<u>Presentation of the investment policy of CISs using portfolio insurance techniques</u>

- Some management strategies aim at preserving the capital at maturity, without this performance objective being formally guaranteed by a depository institution, a credit institution or an investment firm (pursuant to Article R214-19 of the Monetary and Financial Code). In this case, the *Autorité des Marchés Financiers* demands that the term "guaranteed" not be used to phrase this objective. One shall instead opt for a wording like *"capital preservation objective carrying a risk of capital loss"* and precise that the capital is not guaranteed.

<u>Recommendation:</u>
For CIS using portfolio insurance techniques (Constant proportion portfolio insurance techniques), the *Autorité des Marchés Financiers* recommends:
- Highlighting the logic of participation in the performance of a high-risk asset class and of a low-risk asset class in their objective;
- Not mentioning a quantitative investment objective. Indeed, unlike classic investment strategies which suffer the consequences of market declines but nevertheless offer the opportunity to reap the benefits of a market rebound, portfolio insurance investment strategies can lead the CIS to invest in monetary assets only, i.e. using safe management strategies until it reaches maturity in order to honour its commitments to preserve capital. This implies a very special and non-Gaussian dispersion of the returns generated by these strategies and makes it irrelevant to set a performance objective based on the strategy's historical average performance.

[4] This presentation is likely to hinder investors' understanding of the strategy, for whom the differences between the notions of investment and exposure are not obvious..

- Some CISs implementing portfolio insurance management techniques (Constant proportion portfolio insurance techniques) use investment strategies which allow them to have at all times minimum exposure to these risky assets and thereby avoid that the fund be entirely invested in monetary assets. In practice, when risky asset prices decline sharply, the residual exposure is very low because the "minimum exposure" is offset by a Put option on risky assets.

<u>Recommendation:</u>
In such situations, the *Autorité des Marchés Financiers* recommends avoiding using wordings that would suggest that the investment strategy allows escaping the risk of having the fund invested in monetary assets only, given the very low level of residual exposure to risky assets, should the prices of the latter drop sharply.

All the information contained in the prospectus and needed for investor understanding shall be included and summarised in the "Investment objective and policy" section of the KIID.

<u>Balanced presentation of the investment policy</u>

- The description of the investment policy shall be well-balanced.

- The wording of the investment policy shall not suggest that the strategies implemented bear no risk and always win.

<u>Recommendation:</u>
Using wordings like *"the asset manager will accumulate gains by implementing short-term strategies on future equities, bonds, and commodities"* should be avoided.
One may instead opt for a wording like *"the asset manager will seek to outperform the money market return by identifying and implementing short-term strategies on future equities, bonds and commodities."*
In a similar way, using wordings like *"the asset manager will cut exposure to the equity markets in the event of a market decline"* should be avoided. One should instead write *"the asset manager will be able to cut exposure to the equity markets if it anticipates a decline in these markets"*.

- Implementing discretionary strategies
  Strategies that heavily rely on a discretionary approach sometimes give little information on the allocation methods used by the asset management company managing the CIS.

<u>Recommendation:</u>
It is recommended to precise the targeted risk/reward profile and the investment ranges, whether they are imperative or indicative, with as many target allocations as possible. These indications makes the information clearer and help investors better understand the risk/reward profile of the CIS.

Moreover, the *Autorité des Marchés Financiers* recommends that the discriminatory selection criteria for building the portfolio (looking for low volatility, undervalued equities according to the fundamental analysis conducted by the asset manager, etc…) be highlighted in the investment strategy in order to help investors have relevant information as regards the investment strategy implemented or the financial instruments used. For instance, for funds of funds, indicating only that the underlying investment funds are selected on the basis of a qualitative and quantitative analysis does not allow investors to understand the portfolio risk/reward profile in a manner sufficiently clear and transparent.

- Using the quantitative model
  When using a quantitative investment model, one can notice that the algorithmic methods to build the portfolio are often presented as the result of an "optimisation of the risk/reward profile." This optimisation process is often defined as a "constrained optimisation" (for instance constrained by volatility), which reduces the performance potential of the CIS. Referring to "optimised" management is, under such circumstances, non-transparent and likely to mislead investors. In such situations, the impact of the "constraints" on the fund's performance must be brought to the forefront in the investment policy.

Recommendation:

Where CISs use a quantitative investment model which nevertheless limits volatility and leverage through optimised management of the risk/reward equation, it is recommended to precise that the volatility and leverage effect constraint reduces the performance potential of the strategy and the risk level of the instrument at the same time.
Besides, if some market conditions have a particular negative or positive impact on the behaviour of the model, it is recommended to identify and indicate these conditions.
CISs using a trend-following model with a monthly update of the portfolio can indicate that they will take into account the sharp price movements in the capital markets late, which may ultimately have a negative impact on their performance.

- Using extra-financial criteria

It is possible to use extra-financial criteria to select the financial instruments composing the portfolio of the CIS. In this case, these criteria shall be briefly described in the KIID.
The conditions under which it is possible to use these criteria are detailed in the AMF position 2007-19 *"Extra-financial criteria for securities selection and application of these criteria to funds declaring themselves compliant with Islamic law."*

- Using financial futures instruments

The consolidated presentation of the fund's exposure, which is based on its direct investments and on the use of derivatives, helps reduce the volume of information documented pertaining to financial derivatives instruments.
When using financial futures instruments or other investment techniques (securities lending and borrowing for instance) leads the fund to take an exposure to certain specific markets superior to 100% of its net assets, which is amplifying the price movements in the market, whether it be bullish or bearish, this piece of information shall appear in the investment policy and the minimum and maximum level of exposure shall be stipulated.

Recommendation:

It is recommended that the reference to the use of derivatives instruments does not restrict itself to indicating that the global risk of the CIS associated with financial futures instruments will be limited to 100% of the assets: this information merely refers to a regulatory requirement relating to the method for calculating the fund's commitment, without giving any real information on the cumulated level of exposure resulting from the on-balance sheet and off-balance sheet positions.

When funds use financial futures instruments only to manage the flow of subscriptions and redemptions without resulting in the exposure exceeding 100% of the net assets, it is recommended that this information be disclosed in the prospectus only.

Reference indicator

If an indicator is available in a version that takes into account the dividends or coupons reinvested, the performance achieved by the CIS shall systematically be compared to that of the said indicator in order to avoid providing investors with potentially misleading information.

Should the indicator only be available in a version that does not take into account the dividends, the information provided shall be as clear as possible as regards the bias affecting the comparison between the performance of the indicator and that of the CIS.

Recommendation:

It is recommended to refer to sources of information providing data on the index in order to help investors indentify the said data unambiguously and track the changes in the index in real time if they want to.

The AMF requires that the term "indicator" be used instead of "index" when the indicator does not offer the guarantees usually expected for the development and dissemination of an index.
Accordingly, a CIS the benchmark indicator of which is the average performance achieved by funds belonging to an asset clase that has been defined by a data provider (in the category "CIS invested in French equities") shall refer to it using the term "indicator" and not "index".

In order to provide investors with clear, accurate and non-misleading information, comments on the index mentioned in the chapter relating to good practice for drafting commercial documents and marketing financial instruments shall be taken into account when writing the section relating to the benchmark indicator. In particular, the index shall be named "strategy index" if the rules for its composition and weighing seek to generate a bias compared to the markets or to outperform them. In addition, the existence of calculation rules which provide for giving away a portion of the performance achieved by the fund in the form of fees shall be mentioned to investors (by stipulating *a priori* the methods for applying these rules and where investors can find figures on the impact of these fees on the performance). The procedures which allow investors to access to information on the index composition or on its operating rules shall be stipulated.

Presentation of the recommended investment period

The recommended investment period shall be consistent with the classification and the composition of the fund's net assets, and with the investment strategy defined in the KIID and prospectus.

1.1.2.4. Risk and reward profile

This section includes a synthetic indicator supplemented by:

- A textual explanation of the said synthetic indicator and of its main limits
- A textual explanation of the risks which are important for the CIS but which are not properly assessed by the synthetic indicator

The textual explanation aims at helping investors understand which risks entailed by the CIS are not taken into account by the indicator and compare this risk profile with that of other CISs.

The asset management company decides on a case-by-case basis which specific risks need to be presented by analysing the characteristics of each CIS, without losing sight of the necessity to avoid overloading the information document. The part dedicated to the textual explanation of the risk and reward profile in the KIID shall be limited and only the risks that do have a great impact on the risk and reward profile of the CIS shall be stipulated.

Recommendation:
It is recommended that the operating risk be mentioned only on an exceptional basis and not systematically in the KIID of those CISs belonging to a specific category. Such risk may only be mentioned if it has a great impact on the fund's risk and reward profile.

Conversely, the textual explanation of the risks that are not being properly assessed by the aforementioned synthetic indicator is not intended to explain the risk management procedures implemented by the asset management company. It is also not intended to detail all the risk reduction strategies implemented by the asset management company. If the scheme implemented for reducing or hedging the risks is of interest as regards the fund's investment strategy , it shall be mentioned in the section "Investment strategy" of the prospectus and, where appropriate, in item "Investment policy" of the KIID.

For instance, a CIS invested in the American markets and the units of which are denominated in euro bears the foreign exchange risk between the dollar and the euro. If it hedges the currency risk, it shall be mentioned in item "Investment policy" of the KIID and prospectus. By contrast, should the fund only bear a residual foreign exchange risk, resulting from the imperfections of the hedges put in place, it is recommended not to mention this residual risk in the KIID and to refer investors to the prospectus for a detailed description of it.

Liquidity risk

The liquidity risk is a risk associated with low liquidity in the underlying markets, which makes them sensitive to significant buy and sell orders.
It shall not be confused with the risk of the asset management company not being able to honour the redemptions without breaching the principle of investors' fair treatment. Indeed, the Monetary and Financial Code requires that the asset management company make all the necessary arrangements to manage the liquidity risk. It is only under exceptional circumstances that the realisation of liquidity risk can result in the subscriptions and redemptions being suspended. Accordingly, it shall be underlined that mentioning the liquidity risk does not alter the liability of the asset management company, which shall ensure that the nature and level of the positions held in the portfolio are not likely to jeopardise the fund's ability to sell these positions under conditions satisfactory to investors. The operating rules of the CIS (in particular the subscription and redemption procedures) may contribute to managing effectively the liquidity and costs associated with investments and divestments.

In the case of CISs investing in socially responsible securities, it should be noted that since the market for socially responsible securities is relatively small, liquidity management may be affected.
In particular, since asset management companies have the duty to honour at all times the redemption requests for units in the CIS they manage, they must make arrangements accordingly, by introducing liquidity contracts for instance.

As regards the valuation conditions, the characteristics of socially responsible securities shall be taken into account in an adequate manner in the valuation process.
Lastly, the information disclosed, in particular in the prospectus, shall clearly mention the risks and characteristics of these securities in the sections “Investment strategy” and “Risk profile”.

The provisions set forth in the information document of a feeder fund as regards the subscription or redemption of units in a master fund

The liquidity risk and provisions for the redemption of units in the master fund are explained in the section “Risk and reward profile” contained in the KIID of the feeder fund.

For instance, in order to present the provisions for the redemption of units in a master fund, the section “Risk and reward profile” contained in KIID of the feeder fund may include the following notice:
[The terms and conditions for the subscription and redemption of units in a master fund are detailed in the paragraph “Conditions for subscription and redemption” under the section “Investment policy and objective”].

The counterparty risk

The counterparty risk shall be mentioned when a CIS uses, to a large extent, one or several financial contracts with a counterparty.

Recommendation: If the CIS uses financial contracts (financial futures instruments) or lend or borrow securities (or securities financing transactions) to a large extent as part of its investment strategy but where the latter is not based on investment in these contracts only, it is recommended not to mention the counterparty risk systematically.

CIS with an exposure to commodity indexes

The conditions under which a CIS can gain exposure to commodity indexes have been set out by the *Autorité des Marchés Financiers* in 2005. It is reminded that exposure to commodity futures bears specific risks which need to be described in the section “Risk and reward profile”.

1.1.2.5. Costs

Running costs

The running costs include all the operating and management costs charged to the CIS, net of repayments. These costs notably include :

- The management costs;
- The depositary-related costs ;
- The brokerage costs, [where appropriate] ;
- The costs related to the investment adviser, [where appropriate] ;
- The accounting fees ;
- The costs related to the assignees (financial, administrative and accounting), [where appropriate] ;
- The turnover commissions ;
- The fees related to the registration of the fund in other member states [where appropriate]
- The audit costs [where appropriate] ;
- The legal fees, [where appropriate] ;
- The distribution costs ;
- The entrance and exit fees when the CIS subscribes or redeems units or shares in another CIS or investment fund.

When the units or shares of the UCITS or AIF are admitted for trading on a regulated market or multilateral trading facility, in application of articles D.214-22-1 and D. 214-32-31 of the Monetary and Financial Code, the fund makes information available to the public, where necessary, regarding the impact of the admission to trading on subscription fees/commissions for investors using this distribution method.

Recommendation:
In the case of exchange traded funds, it is recommended that the costs disclosed be supplemented with information stipulating that additional costs (brokerage fees, stock market fees, etc,) may be charged in addition to those already disclosed.

Funds of funds

When a CIS invests more than 20% in another CIS, the running cost rate shall take into account all the costs incurred by the CIS in its capacity of investor in the underlying CIS. In particular, the fund shall take into account the running entrance and exit fees charged by the underlying CIS when calculating its own running costs.

1.1.2.6. Past performances

General information

Information on the past performance of the CIS shall be communicated in the form of a bar chart.

The performances are presented as follow:

- The chart, pursuant to the *Global International Performances Standards* shall, present the annual performances;
- The performances of the fund are presented with the reinvested coupon payments ;

- The performances of the benchmark indicators are presented with the reinvested dividends whenever possible. Where it is not possible, this shall be clearly mentioned in the comments. For instance, one may indicate: *"the fund's performance is calculated with net coupons reinvested. Conversely, the performance of the benchmark indicator does not take into account distributed income."*

Updating the performances

Updating the performances takes place at the beginning of the calendar year, on the basis of the previous calendar year and independently from the financial year-ends.

Extrapolating the performances achieved over a period of less than one year to project the performance of the calendar year is forbidden. Information on past performances is updated every year, at the latest 35 working days after the end of the calendar year.

Moreover, it is not necessary to update the performances on a more frequent basis (for instance every 6 months), since only the performances of the full calendar years are displayed.

Methods for calculating the performance

The performance is calculated on the basis of the net asset values.

1 + Perf(t,t+1) = NAVt+1/NAVt * Coefficients

The coefficients help adjust the performance when the coupons are being detached or the security transactions executed. For coupons for instance, Coefficient = (1+ first NAV after the detachment of the coupon)

In addition, measuring the performance shall be carried out between the last working days of every calendar years.

Recommendation:
Should the CIS fail to set a net asset value on the last working day of the calendar year, it is recommended to set and publish an estimated net asset value[5] and to measure the performances on the basis of this value. Failing this, the performance will be measured on the basis of the last net asset value of each calendar year. The performance achieved over the calendar year shall not be annualised or reprocessed.

The performance of the benchmark indicator shall be measured according to the same principles as those for measuring the performance of the net asset value, both as regards the dates chosen and the method used (opening price, closing price, etc…). Should market data using the same basis for calculation be not available, it shall be clearly stipulated. For instance, it should be indicated when the net asset value is calculated on the basis of the opening price while the indicator is calculated on the basis of the closing price.

Changing the investment direction of the CIS

When the strategy changes during the period covered by the bar chart, the performances achieved by a fund prior to this important change shall continue to be displayed in the chart. The two periods shall be materialised in the chart.

Conversely, when a CIS softens or toughens the investment rules governing its legal category, performances that were achieved by the fund before the change cannot be displayed. This is the case, for instance, when an approved fund reserved for specific investors is transformed into a UCITS. Past

[5] Article 411-47 of the AMF General Regulation

performances may only be recorded if, and only if, the fund has never used the derogatory investment rules it could exercise and that it has, as of its creation, complied with the new investment rules set out at the time of transformation.

1.1.2.7. Practical information

Practical information that needs to be provided to investors is detailed in the standard template set out in 1.1.

When the units or shares of the UCITS or AIF are admitted for trading on a regulated market or unilateral trading facility under the conditions prescribed by the regulation, this section specifies the arrangements for this admission.

<u>Recommendation:</u>
In the case of exchange traded funds, it is recommended to specify, in addition to the practical information already disclosed, the name of the market operator, the trading venue for the fund's units and the following indication *"the indicative net asset value is disseminated in real time by the market operator during the trading hours"* in order to provide investors with comprehensive information.

1.1.2.8. Structured funds

All the aforementioned provisions are applicable to all structured funds. This part of the guide only aims at specifying which additional information needs to be displayed in the KIID, given the characteristics of the structured funds.

Structured funds are CISs which offer investors returns that are calculated on the basis of an algorithm and which depend on the performance or on the price movements in financial assets, reference indexes or portfolios, or CISs with similar characteristics.

Structured funds offer an extremely wide range of risk and reward profiles. Accordingly, it is not possible to anticipate all the situations likely to be encountered. Overall, asset management companies must ensure that the presentation of the formula is well-balanced, in particular if the fund is structured in such a way as to allow changing the risk and reward profile compared to a direct investment in the underlying assets of the structured fund. Using wordings that would suggest, for instance, that risk reduction is not linked to the reduction of the performance likely to be offered would be potentially misleading. In that respect, juxtaposing terms like "performance" and "security" (or any equivalent) shall be prohibited.

<u>Investment policy and objectives</u>

Whether the CIS offers capital guarantee at maturity or not shall be explicitly and visibly indicated.
For instance, a title block in front of the section "investment policy and objectives" may be included. It may include the mentions "capital guaranteed at maturity" or "capital not guaranteed at maturity", as the case may be.

The terms used to describe the formula shall be non-misleading. They shall not be given a different meaning than the meaning commonly accepted and their name shall not omit one or several significant characteristics of their definition.

For instance, it shall be avoided to use the term "stock performance" to name the lowest stock performance for the past four reporting dates. In a similar way, it shall be avoided to use the term "basket performance" to name the average of the ten worst performances achieved by a basket of twenty stocks.

- When the formula is based on the lowest performance, or lowest performances, ("worst of" formula) of one or several underlying assets comprising a basket, the *Autorité des Marchés*

Financiers asks that wording suggesting that the formula is indexed to the whole basket be avoided.

For instance, a structured fund that would yield, after five years, a return 10% higher (or lower) than the increase (or decline) in the 10 worst stocks of a basket of 20 stocks shall avoid the following formulation:
At maturity:
- The performance of the 10 best stocks is replaced by 1%
- The performance of the 10 worst stocks is set to its real value
It is preferable to use a wording that would explicitly indicate that the structured fund is indexed to the performance of the 10 worst stocks.

- When the formula proposed by a structured fund is indexed at up to 100% to the average performance of an index or when it is indexed to the performance of the index, although capped, the fund shall not use the indexation level as a basis for its communication strategy.

  The investment objective shall not be phrased as follow: *"offering, when the three-year investment period ends, 100% of the reference net asset value increased by 100% of the average increase of an index within a 30% performance limit"*, insofar as insisting on the level of indexation to the average increase in the index could be considered as misleading, given the fact that the performance is capped. The investment objective should instead be phrased as follow: *"the investment objective is to offer, after a three-year investment period, the reference net asset value increased by the average increase of the index X within a 30% performance limit, that is a maximum annual rate of return of 9.14%"*. For the rest, the two formulas are identical (100% of the average increase within a 30% limit = average increase within a 30% limit)

- Structured funds which offer a performance (linked to the price movements of an index or basket of shares) with a reference level for calculation lower than the amount of capital initially invested are required to state very clearly the investment objective. It shall be avoided to suggest that investors reap the full benefits of the index performance.

  Thus, for instance, a structured fund with a maturity of 4 years which would aim at offering at maturity the following repayments:
  - 90% of the capital
  - And the final performance of the CAC 40 index compared to its initial level within a 50% limit shall clearly indicate that:
    - If the final performance of the CAC 40 index is below 10%, investors lose capital;
    - If the final performance of the CAC 40 is equal to 10%, investors recover the capital they initially invested;
    - If the final performance of the CAC 40 index is more than 10% but below 50%, investors recover the capital they initially invested increased by the index performance minus 10% ;
    - If the final performance of the CAC 40 index is superior to 50%, investors recover the capital they initially invested increased by 50% minus 10%, i.e. a maximum performance of 40%, or a maximum annual rate of return of x%.

Risk profile

It is recalled that the numerical scale shall be supplemented by a text explaining the characteristics of the synthetic indicator and its major limits. This text shall specify the nature, term and scope of the potential capital guarantees or protections.

- Guarantee or protection
  The issue is to determine whether the capital is guaranteed or not, at all times, and/or at maturity. The conditions under which partial capital protection might be offered, optionally contingent upon the changes in an index, are described in the text.

When market assumptions anticipate that the performance of the formula will always be superior or equal to 0, the term “conditional capital guarantee” shall not be used.

Accordingly, a fund offering an annualised performance of 5% where the CAC 40 index does not decline by more than 30% over the next five years cannot pretend to offer a *“conditional capital guarantee if the CAC 40 index does not decline by more than 30% over the next five years.”*

<u>Recommendation:</u>
Where the capital is not guaranteed but a partial guarantee exists, the *Autorité des Marchés Financiers* recommends avoiding wording like *“partial guarantee of up to 90% of the invested capital”,* which might be misunderstood. The AMF recommends stipulating systematically that the capital is not guaranteed and instead using a more neutral term like “partial capital protection” to mention this partial guarantee.

When one of the elements of the formula carries a risk of capital loss at maturity, the KIID shall clearly identify this risk in a text explaining the risk incurred by the fund, though not properly assessed by the synthetic indicator.

- <u>Coupon payments</u>
  When the fund distributes or accumulates coupons during its lifetime while carrying a risk of capital loss at maturity, these coupons may be considered as early repayment of the capital, either in part or in full, and are not a promise of future rewards.

<u>Scenarios</u>

The examples used in the following favourable and unfavourable scenarios are based on reasonable and prudent assumptions about future price movements and market conditions.

The rate of return of the formula for these different scenarios must be displayed in the form of an annualised rate of return. The gross rate of return may be displayed too.

Besides, performance scenarios for structured funds shall be supplemented by a textual explanation of the pros and cons of the formula, as soon as they have not been detailed in the section “Risk and reward profile.”

This explanation aims to help investors understand the pros and cons of the proposed formula.

The structures listed hereinafter are not exhaustive; they reflect the situations already encountered by the *Autorité des Marchés Financiers* and highlight the associated disadvantages.

- <u>Performance indexed to the best of several profiles</u>
  Certain specific formulas are indexed to the best of several profiles. These profiles have common components, which thereby reduces the decorrelation risk and, hitherto, the potential performance gaps at maturity. This is a disadvantage of the formula.

  Accordingly, a structured fund may be indexed to the best of the three baskets:
  - An “equity” basket (60% CAC 40 – 20% EuroMTS 5-7 years – 20% EONIA)
  - A “rate” basket (20% CAC 40 – 60% EuroMTS 5-7 years – 20% EONIA)
  - A “safe assets” basket (20 % CAC 40 – 20% EuroMTS 5-7 years – 60% EONIA)

  These three baskets have in common 60% of their respective exposure (20% CAC 40 – 20% EuroMTS 5-7 years – 20% EONIA). Consequently, only 40% of their respective exposure differs from each other. This reduces the interest of a formula indexed to the best of these three baskets, which is a disadvantage.

- Uncertainty about the investment period

  When structured funds offer one or several possibilities of early withdrawal, depending on the market conditions, it shall be mentioned as a disadvantage that investors are unsure about the term of the investment period.

  Accordingly, a structured fund which offers a performance equal to 60% of the average performance achieved by an index with a maturity of three years and which offers the possibility of early withdrawal, i.e. repayment of the capital after one year, coming with a fixed return of 10% if the index achieves a performance higher than its initial level over a similar horizon, is required to mention clearly in the textual explanation of those risks which have not been assessed by the indicator that investors do not know in advance the term of their investment, which can be one or three years.

- Capped performances

  Some formulas are indexed to an underlying asset with a cap on increases. This cap is a disadvantage of the formula.

  Some formulas are indexed to an underlying asset with no cap on increases but with calculation methods which drastically limit the formula's performance potential compared to a direct investment in the underlying asset. The absence of a cap does not represent an advantage then.

  Thus, it shall be avoided to mention that *"the performance is not capped"* for a formula that is indexed to the 10 lowest performances of a basket of 20 shares.

- Other cases

  If certain market conditions have a particularly negative or positive impact on the formula's behaviour, these situations need to be identified and indicated.

- Impact of the dividends (or any other equivalent situation)

  If the performance offered to investors or the reference performance for measuring the formula is calculated excluding dividends or equivalent, this shall be stipulated in the disadvantages ("Excess return" for commodity futures indexes for instance).

- The notion of average

  Where a fund is indexed to the time-averaged performance of an index, the scenarios will present the positive impact of the formula if the reference index declines at the end of the fund's term and the negative impact of the formula if the index achieves a regular performance or if it strongly increases at maturity of the fund.

  Where the fund offers time-averaged performances of the underlying assets (indexes, equities, etc…) when calculating of the formula, this usually results in the fund's performance being reduced if the price of the underlying assets increases, either continuously or at maturity of the fund. Conversely, it results in the fund achieving a better performance if the price of the underlying assets declines, either continuously or upon maturity of the fund.

- "Worst of" basket formulas

  When the formula is indexed to the lowest performance, or performances, of a basket of underlying assets, it is, by construction, not indexed to all the underlying assets comprising the basket. Consequently, investors waive the right to benefit from the performance of the basket and, a fortiori, from the performance of the most performing underlying assets comprising the basket.

1.2. KIID for non-UCITS and real estate funds available to the general public

The texts referred to in 1.1.1 of this document shall apply as a whole

All the aforementioned provisions are applicable to all non-UCITS and real estate funds.

The following elements only aim at supplementing the information disclosed in the KIID, depending on the characteristics of each kind of non-UCITS or real estate fund[6] and at specifying the complementary doctrinal elements applicable to them.
It is reminded that, just like for UCITS, the KIID shall not exceed two A4 pages, except for structured funds and structured real estate funds, the KIID of which shall not exceed three A4 pages.
By way of derogation, the KIID for private equity funds shall not exceed two A4 pages, excluding cost tables, carried interest tables and performance scenarios.

Since these CISs or real estate funds are non-UCITS, it shall be specified in the header of the KIID that *"this CIS or real estate fund is a non-UCITS and is governed by French Law."*

In addition to this information, it may be mentioned, where appropriate, that the non-UCITS complies with the investment and information regulation of Directive 2009/65/CE.

1.2.1. The characteristics of CISs and/ or real estate funds reserved for specific investors

Where a CIS or real estate fund is reserved for specific investors only from a regulatory perspective, the section "practical information" should provide complementary information on the types of investors to whom the fund is aimed at, in addition to the information on the legal status of the CIS. This is applicable for:

- Approved CISs reserved for specific investors (ARIA funds and alternative funds of funds),
- CISs reserved for a maximum of 20 investors or for one category of investors,
- Real estate funds reserved for a maximum of 20 investors or to one category of investors,
- Real estate funds with streamlined investment rules and with a leverage effect,
- Employee savings funds.

<u>Approved CISs reserved for specific investors (ARIA funds and alternative funds of funds) or Real estate funds with streamlined investment rules and with a leverage effect</u>

<u>Recommendation:</u>
Where the status of a CIS or real estate fund allows it to benefit from less stringent requirements than generalist CISs or generalist real estate funds, it is recommended to mention the additional risks arising from these relaxed rules in the section "Risk and reward profile". Usually, these risks are, on the one hand, those associated with the concentration of investments, since approved CISs reserved for specific investors (ARIA funds and alternative funds of funds), or real estate funds with simplified operating rules and with no leverage effect may be granted derogatory risk dispersion ratios and, on the other hand, the risk associated with the existence of a subscription or redemption notice period, since the value of the CIS or real estate fund may strongly vary between the subscription or redemption date and the execution date.

1.2.2. The characteristics of employee savings funds (FCPE and SICAVAS)

Shifting from the information note to the KIID is not a transformation of the CIS but merely a change in the presentation of the fund's main characteristics. Accordingly, it is not required to secure approval by the supervisory board, except where otherwise provided for in the Regulations of the fund.

1.2.2.1. Sections pertaining to the presentation of the KIID

<u>Funds of funds</u>

The diversification ratios applicable to funds of employee savings funds are, for some of them, less stringent that those applicable to generalist funds of funds. The information communicated to investors in

[6] This stands for generalist non-UCITS, alternative funds of funds, employee savings funds (FCPE/SICAVAS), real estate funds available for the general public, real estate funds with streamlined investment rules and without a leverage effect and approved private equity funds (private equity funds, innovation funds and local investment funds)

the case of certain specific funds of employee savings funds shall be adapted accordingly. Thus, CISs investing more than 50% in a unique target fund shall indicate the name of this fund in item “Investment objectives and policy” and the conditions under which the KIID may be available to investors in the section “Practical information.”

Recommended investment period

The recommended investment period in a FCPE/SICAVAS shall take into account the investment policy implemented and the financial instruments used and it cannot overlook the specific tax conditions applicable to employee savings fund s and their impact on investors.

For instance, in order to provide clear information, the investment period shall be indicated without taking into account the fact that savings are blocked. If the investment period is shorter than the blocking period, the following mention may be used: *“The recommended investment period does not take into account the blocking period during which your savings will be blocked. The said holding period is […], except in the case of early withdrawal as provided for in the French Labour Code.”*

Costs

If costs are not charged to investors, this may be mentioned below the cost table.

Supervisory and governance board

The presence of a supervisory and governance board is what makes FCPE special. In this context, the role, composition and method of appointment of the members of the supervisory board shall be briefly described in the section “practical information.”

Employee savings fund s invested in corporate securities

The incorporation and information procedures governing employee savings fund s which invest in corporate securities have been published in a specific publication released by the *Autorité des Marchés Financiers* (AMF position – recommendation 2012-10 – Guide to the employee savings fund s)

Supervisory and governance board

In addition to the information on the role, composition and method of appointment of the members of the supervisory board, the policy implemented by funds which invest in securities of the company in respect of the distribution of dividends, the exercise of voting rights attached to these securities of the company and the conditions for accessing to periodic corporate information shall be specified.

Risk profile

The risk profile of funds investing in securities of the company must draw investor attention in a very precise manner on the degree of risk concentration borne by a single issuer within the FCPE/SICAV.

For instance, a fund which invests in securities of the company may indicate: *“The fund incurs a specific equity-related risk (or a rate-related risk) insofar as it is invested at more than X% in securities in the company. Should the value of the company’s security decline, the fund’s net asset value will drop too.”*

CIS invested in securities non-eligible for trading on a regulated market

Risk and reward profile

Methods for calculating the synthetic indicator which are based on volatility are not relevant for employee savings fund s invested in securities non-eligible for trading on a regulated market.
In this context, the *Autorité des Marchés Financiers* recommends measuring the risk scale on the basis of the degree of riskof capital loss arising from the instrument and documenting it in the KIID.
For instance, in the case of employee savings fund s invested in securities non-eligible for trading on a regulated market which carry a high risk of capital loss borne by a single issuer, the box 7 in the risk scale of the synthetic indicator seems more appropriate to illustrate the degree of risk associated with this investment.
The textual explanation of the indicator provides the necessary details for investors to understand the degree of risk indicated by the indicator, its major limits and the explanation of the major risks incurred by the fund which have not been taken into account by the indicator.

Valuation method

The valuation method is important information that needs to be communicated to investors. In that respect, the key elements of the method defined by the independent expert in his report shall be displayed in item “Practical information” of KIID or, failing this, in an annex to the KIID.

For the record, additional information on this issue may be found in the AMF position – recommendation 2012-10 – A guide to employee savings funds, dealing notably with FCPE/SICAVAS invested in securities of the company.

Liquidity mechanisms

Where the guarantee that makes it possible to meet the liquidity requirements covers a predetermined amount, a level of liquidity equivalent to the level of liquidity that the fund would have if it held at least one third of liquid securities shall be proposed, pursuant to Article 30-10 of the AMF instruction 2011-21. In order to ensure that the guarantee covers at all times one third of the fund’s net assets when the guarantee agreement covers a predetermined amount, this amount shall initially account for at least 50% of the fund’s net assets and the agreement shall provide for a clause requiring that the amount be renegotiated as soon as it accounts for only 35% of the fund’s net assets.

Thus, it is possible for a FCPE/SICAVAS to combine two methods, to have liquid securities accounting for a percentage of the fund’s net assets set out in its regulation, supplemented by a liquidity guarantee mechanism effective up to an aggregated level equal to one third of the fund’s net assets.

The liquidity mechanism used shall be indicated in the section “Practical information” of KIID.
The details of the mechanism may be referred to in the fund’s regulation.

Employee savings funds with a leverage effect

The terms and conditions for terminating swaps in structured employee savings fund s

In the case of certain specific structured employee savings funds, the conditions under which an outstanding swap agreement may be terminated during the term of the fund can are special, in particular when they result in withdrawal terms and conditions different from those expected at maturity. If they pose a risk for investors, they shall be referred to as a disadvantage associated with the proposed fund structure.
Thus, for instance, structured funds in which a swap agreement may be terminated on the basis of the formula's net present value shall mention the risk arising from termination in item "Performance scenarios" of the KIID.

Capital guarantee or protection

For better understanding, it may be needed to add in the section "Risk and reward profile" the following: Whether or not a capital guarantee or protection exists and, as appropriate, an explicit description of the rights waived by investors to finance the implementation of the formula (discount, dividends, portion of the increase).
For the record, it bears referring to the Guide to employee savings funds (AMF position – recommendation 2012-10) as regards those special procedures governing employee savings funds with a leverage effect.

Performance scenarios

The scenarios are presented as "illustrative examples" and shall by no means be presented as forecasts likely to occur. They may take the form of charts or graphs. It is recommended to use the format which presents the characteristics of the formula in the clearest manner.

The explanation of the formula or method for calculating the remuneration is supplemented by an illustration displaying at least three performance scenarios likely to occur. They help investors fully understand all the effects of the calculation method for setting the formula. In particular, they do not appreciate artificially the final performance of the fund.

These scenarios are chosen so as to show under which circumstances the formula can offer high, average or low return, or, as the case may be, a negative return on investment.
They are accompanied by a note stipulating that those are examples aimed at illustrating the formula but are not, in any way, forecasts of what might happen. It shall be clearly stipulated that these scenarios are not equally likely scenarios.

These scenarios are intended to show:
- How the formula works in unfavourable, favourable or intermediate market conditions;
- The mechanisms specific to the formula used (formula with a capped performance or a leverage effect);
- The circumstances under which these mechanisms have a favourable or unfavourable impact on the final performance.

Given the characteristics of each formula, a fourth scenario may be needed to properly describe the way the formula works.
The examples used for these favourable and unfavourable scenarios are based on reasonable and prudent assumptions about future price movements and market conditions.
However, each time the formula exposes investors to a risk of major loss, for instance when a capital guarantee is effective only under specific circumstances, these losses shall be properly illustrated, even where the probability that market conditions may result in such losses is low.

Temporary investment funds

<u>Temporary investment funds and subscription procedures</u>

The *Autorité des Marchés Financiers* released information on the procedures governing the launch of a capital increase through a temporary investment fund, whether with a subscription formula or not (AMF position – recommendation 2012-10 – Guide to the employee savings funds).

Since these funds are intended to be merged with the employee savings fund within a limited time period, it is proposed that a simplified KIID be articulated.

In this context, the section "Investment objective and policy" must be filled out. Conversely, other sections like those relating to the costs or practical information shall be filled out only if they are different from those of the employee savings fund.
The KIID of the employee savings fund shall be annexed to that of the temporary fund.

1.2.3. Characteristics of the sections pertaining to the presentation of the KIID for investors investing in approved private equity funds (private equity funds, innovation funds and local investment funds)

<u>Denomination</u>

Using the initials "ISF" to name an approved private equity fund is possible when a tax and legal analysis has been carried out by the asset management company when the fund filed file for approval in order to determine whether the fund is entitled to a reduction of the wealth tax.
Moreover, the characterisation "FIP-ISF"; which is not a legal characterisation, shall be set aside in favour of wording like "local investment fund eligible to a reduction of the wealth tax".
Under all circumstances, the regulatory documents shall be supplemented with information on the risks and holding period of the assets associated with the investment in these vehicles.

<u>Investment objective and policy</u>

Private equity funds shall provide additional information on the different life stages of the fund (investment, divestment, pre-withdrawal and, if applicable, withdrawal) and on the holding period of the assets in the section "investment policy" in order to help investors better understand the functioning of the instrument .

For instance, the following sentence may be written: *"this fund has a term of x years (extendible x times x years on the decision of the asset management company, if applicable) during which redemptions are not authorised. The investment phase shall basically last as of the incorporation of the fund until [to be fill out]. The divestment phase shall start on year X. In any case, the withdrawal process will end on [to be fill out] at the latest and investors shall be fully repaid at this date."*
The investment policy may also be presented in the form of a pattern.

<u>Risk and reward profile</u>

Methods for calculating the synthetic indicator based on volatility are not relevant for private equity funds.
In this context, the *Autorité des Marchés Financiers* requires that the risk scale be measured on the basis of the degree of risk of capital loss arising from the instrument and documented in the KIID.
For instance, since private equity funds carry a high risk of capital loss, the box 7 in the risk scale of the synthetic indicator seems more appropriate to illustrate the degree of risk associated with this investment.
The textual explanation of the indicator provides the necessary details to help investors understand the degree of risk indicated by the indicator, its major limits and the explanation of the major risks posed by the fund which have not been taken into account by the indicator.

Past performances

Since displaying the past performances throughout the term of the fund is not relevant for private equity funds, innovation funds and local investment funds aimed at the general public, such information shall not be included in the KIID.

1.2.4. Characteristics of the sections pertaining to the presentation of the KIID aimed at investors investing in real estate funds

Investment objectives and policy of the real estate fund

The investment policy of real estate funds shall include information on the debt policy adopted by the real estate fund and the maximum debt ratio that it commits not to exceed.
This maximum debt ratio includes the total debt, in the broad sense, of the real estate fund: bank and non-bank debt (comprising overdrafts for instance) as well as direct and indirect debt. Indeed, where the fund invests directly in real estate assets, it is necessary to take into account the indebtedness of the underlying structure to properly assess the total debt of the fund and provide investors with accurate information.

When the investment strategy implemented at the launch of the fund is different than that to be implemented at maturity, the investment policy shall underline this situation and describe the successive strategies implemented. This presentation can take the form of a pattern.

Risk and reward profile

Methods for calculating the synthetic indicator based on volatility are not relevant for real estate funds. In this context, the *Autorité des Marchés Financiers* requires that the risk scale be measured on the basis of the degree of risk of capital loss arising from the instrument and documented in the KIID.
For instance, since real estate funds pose a moderate risk, it seems appropriate to select the box 4, which appears to correspond to the minimum degree of risk in the risk scale of the synthetic indicator. However, asset management companies may be given the possibility to increase this degree according to the volatility of the asset class and real debt of the real estate fund.

The textual explanation of the indicator provides the necessary details to help investors understand the degree of risk indicated by the indicator, its major limits and the explanation of the major risks posed by the fund which have not been taken into account by the indicator.

Redemption procedures

As soon as a real estate fund introduces specific redemption procedures (lock-up on redemption, “Gates”) and as soon as the redemption deadline exceeds five working days, complementary information shall be disclosed in the section “Practical information”.

Costs

The item “running costs” in the cost table shall make a distinction between the management and operating costs and the real estate management costs, thereby providing investors with details on what relates to day-to-day management of the fund and what pertains to real estate management. Moreover, standard procedures governing CISs require displaying the interest rate on the net assets. In the peculiar case of real estate funds, complementary information on the rate on gross assets may be displayed.

1.3. Prospectus (comprising the Regulations or articles of incorporation)

The template outline of the prospectus is set out in instructions 2011-19 and 2011-20 on collective investment schemes, instruction 2011-21 on employee savings funds, instruction 2011-22 on approved private equity funds, innovation funds and local investment funds and instruction 2011-23 on real estate funds.
The aforementioned information is only intended to provide details to readers in order to help them draft a prospectus.

It is recalled that the following provisions shall be included in the Regulations or articles of incorporation of the employee savings funds or private equity funds which do not have a prospectus.

1.3.1. Investment objective of index funds

When a CIS looks to replicate the performance of an index, the investment objective shall specify this objective and provide information on the level of tracking error chosen.

Recommendation:
Using wordings like *"the objective of the fund is to replicate the performance of the index X regardless of its development. The fund aims at preserving the tracking error between the development of the fund's net asset value and the net asset value of the index at a level below Y[7]"* is recommended.
Where the fund is closely linked to an index but may, because of management choices (replication mode, overweight assets, use of derivatives, etc…) deviate from the replicated index by seeking to outperform it, the investment objective should indicate that the target performance is very close to the performance of the index and it should stipulate the chosen tracking error. The following wording is recommended: *"the fund's investment objective is to replicate the index X [to outperform the index Y] within a tracking error limit of Y².*"

Moreover, the index actually chosen shall correspond to the index indicated. For instance, if the fund seeks to replicate the MSCI Japan Euro, it shall by no means replicate the MSCI Japan Yen, and then convert it into Euro using the exchange rate between the Euro and the Yen. It would then ultimately replicate a different index.

1.3.2. Reference indicator

Under all circumstances, if a reference index is mentioned in the KIID, it shall be presented fully in the prospectus[8].
The item in the prospectus shall provide all the necessary information to help investors easily identify the index. Some categories of indexes use highly similar terminologies that may mislead investors. Accordingly, it is important to be very accurate when giving the exact name of the reference index.

1.3.3. Investment policy

The investment policy described in the prospectus[9] should detail the asset classes and classes of financial futures in which the CIS or real estate fund intends to invest and their contribution to achieving the investment objective. This information is stipulated in the instructions 2011-19 and 2011-20 on collective investment schemes, instruction 2011-21 on employee savings funds, instruction 2011-22 on authorised private equity funds, innovation funds and local investment funds and instruction 2011-23 on real estate funds.
In addition, the *Autorité des Marchés Financiers* published a position on the liability of the asset management companies in determining the eligibility of certain specific assets for investment by collective investment schemes (AMF position 2007-20)

[7] The tracking error shall not exceed a determined amount set out in Article 411-35 of the AMF General Regulation
[8] Or the regulation for approved private equity funds and the regulation or bylaws for employee savings fund s.
[9] Or the regulation for approved private equity funds and the regulation or bylaws for employee savings fund s.

Pursuant to Decree 2012-132 dated 30 January 2012, asset management companies shall provide information on whether or not they take into consideration social, environmental and corporate governance criteria as part of their investment policy.

These pieces of information shall be included:

- in the annual reports released by the CIS for fiscal years beginning as of 1 January 2012 on the one hand,
- on the asset management company's website as of 1 July 2012 at the latest on the other hand.

Information on taking account of the social, environmental and corporate governance criteria shall be provided in the investment policy set out in the prospectus of the CIS and on the other media promoting the fund's investment policy.[10]

CISs using portfolio insurance techniques or any other similar technique

It is required to stipulate the nature, term and import of the potential capital guarantees or protections. It shall be specified whether capital is guaranteed or not, at all times or at maturity of the instrument. The terms and conditions under which partial capital protection might be offered, optionally contingent upon the development of an index, shall also be stipulated.
When market assumptions anticipate that the performance of the formula will always be superior or equal to 0, the term "conditional capital guarantee" shall not be used.
The benefits and disadvantages of the strategy shall be stipulated, insofar as the section "rRsk and reward profile" fails to detail them.
This explanation aims to help investors understand the pros and cons of the proposed strategy.

- Multiple and simultaneous guarantees
  Offering multiple and simultaneous guarantees or increasing the guaranteed level throughout the entire term of the fund provides additional capital protection or performance protection. However, they also give rise to an additional management constraint which may result in exposure to risky assets being reduced.

- Absence of external formal guarantees
  Where the fund is structured in such a way as to preserve capital at maturity but is not guaranteed by a depository, a credit institution or an investment firm (pursuant to provisions of Article R214-19 of the Monetary and Financial Code), this absence of guarantee is a disadvantage the consequences of which shall be explained.

- Monetisation risk
  The risk that the CIS may entirely invested in monetary assets, which consists of cutting the fund's exposure to the performance of risky assets totally and definitively, implies that investors waive their rights to benefit from a rebound in risky assets.

- Partial participation in the performance of risky assets
  The chosen structure entails the risk of participating only partially, and not totally, in the performance of risky assets.

[10] Pursuant to Article L. 533-22 of the Monetary and Financial Code, asset management companies shall provide investors in each of the collective investment schemes they manage with information on the procedures to follow in order to meet their social, environmental and corporate governance objectives as part of their investment policy. These procedures specify the nature of these criteria and the way they apply them. They also stipulate how asset management companies exercise the voting rights attached to the financial instruments arising from these choices. Decree 2012-132 dated 30 January 2012 also specifies the media on which such information shall appear and which shall be referred to in the prospectus published by the collective investment scheme.

- Guarantee extension

  Where the investment strategy is implemented over a predetermined time period, and systematically extended, the impact of the systematic extension process on the risk profile of the CIS must be documented.

  Accordingly, a CIS implementing a constant portfolio protection insurance strategy aimed at preserving the capital with a one-year objective and that is automatically extended sees its risk level increasing each time the strategy is extended.

- Systematic managed structured funds

  If certain specific market conditions have a particularly negative or positive impact on the behaviour of the structured fund, these situations must be identified and specified.

- Leverage effect and composition of the risky asset class

  Portfolio insurance strategies are structured is such a way as to reap the benefits of a leverage effect which offers the possibility to adjust exposure to risky assets and offers a return on investment.

  Adjusting this leverage effect is a direct consequence of the composition of the risky asset class, both for actively-managed and passively-managed funds using a constant proportion portfolio insurance strategy, which requires assessing the value of the applicable multiplying.

  The characteristics of the assets comprising the risky asset class need to be highlighted in order to fully explain the imperfections of the adjustment mechanism.

  Let's take the example of low-liquidity risky assets: in order to adjust the leverage level of the strategy during the term of the fund, an allocation adjustment between the two classes that will lead to liquidating the risky assets is needed. The liquidation period can last long and, consequently, delay the effective adjustment, thereby making it impossible to meet the investment objective.

- The impact of volatility on the strategy

  The impact of volatility on adjusting allocation between risky and non-risky asset classes must be clearly highlighted insofar as the performance achieved by the risky asset class relies heavily on the volatile price movements that hit the assets which comprise it. These volatile price movements can indeed amplify the behaviour of the strategy and, notably, speed up the process under which the fund is invested in monetary assets.

  For instance, an asset class made up of non-diversified and highly correlated risky assets that would suffer the consequences of sharp price movements on a stressful trading day would have to change substantially its composition. Such changes may result in the fund being invested in monetary assets more quickly.

1.3.4. Risk and reward profile

Highly discretionary strategies

CISs or real estate funds implementing highly discretionary strategies are required to highlight the risk that a large part of the fund's performance depends on the ability of the asset manager to anticipate the market movements (or any other similar wording).

CISs or real estate funds opportunistically exposed to the interest rate markets, credit markets and equity markets of the industrialised countries shall accordingly mention the aforementioned risk.

Direct or indirect risks

Although the risk profile of the fund needs to describe the risk arising from the strategy implemented by the target funds, it is however important to highlight that the risk profile is not intended, even in the prospectus, to list all the risks the fund is likely to be exposed to indirectly, so as to avoid overwhelming investors with unnecessary and irrelevant information. In practice, it should restrict itself to describing the main characteristics of the exposure arising from the investments in the target funds in terms of the asset classes used and/or strategies implemented. Thus, a bond fund which would not mention any high yield credit risk would not restrict itself from investing in a target bond fund entailing an ancillary risk of such nature.

Short positions

Taking short positions (negative sensitivity or short equity positions) requires vigilance when it comes to documenting the risk profile so as to properly report on the potential final impact of the short positions on the fund's net asset value.

Recommendation:
In the case of CISs with a negative sensitivity to the interest rate risk, it is recommended to avoid wordings like *"interest rate fluctuations may have a negative impact on the fund's net asset value"* and it is recommended to write instead: *"A decline in interest rates may cause the fund's net asset value to decrease."*

1.3.5. Classes of units or shares

Concerned investors

CISs or real estate funds reserved for specific investors shall indicate in this section:
- Either that they are "reserved for 20 investors at most"
- Or that they are "reserved for [one category of investors]", and specify this category.
It is recalled that CISs or real estate funds reserved for specific investors shall not be advertised, sold or be subject to any other type of solicitation to the general public.

Other CISs or real estate funds shall have at least one type of units accessible to all investors (as appropriate, where a minimum subscription amount is required). Clear semantic distinction shall be made, where apporpriate, between the following:
- The classes of units or shares accessible to "all investors, specially aimed at […]", i.e. units for which subscription is not prohibited to investors who are willing to comply with the technical characteristics of the unit (minimum initial investment amount for instance). In this case, indicating merely the target customers for investment in the CIS or real estate fund is required;
- The classes of units or shares "reserved for [a category of investors]", which are accessible only to investors of this category (for instance: units reserved for CISs or real estate funds of the group X)

Differentiating the classes of units or shares depending on the marketing network

It is possible to create classes of units or shares reserved for a specific marketing network.
It is not necessary that these units differ by one other feature than their marketing network. In particular, they can have the same cost structure.

Hedging the risk associated with some units or equities in a CIS or real estate fund

Pursuant to Article 411-22 of the AMF General Regulation, CIS are allowed to create classes of units or shares which put in place a systematic hedging strategy to manage risk, whether the hedge is partial or full, which is defined in the prospectus. In order to minimise the operating risk and ensure that investors are provided with accurate information, the CIS which implement such strategies shall:

- ensure, where appropriate and in collaboration with the asset management company, that they are able to segregate the accounting and financial flows associated with each unit or share and to test the corresponding mechanisms before they are being implemented,
- indicate the hedging policy in the summary table of the investment offer which lists all the units or shares on offer. This hedging policy is necessarily a systematic hedging policy,
- express clearly the hedging policy linked to each unit as part of the investment strategy,
- ensure that the investment objective, the reference indicator, the categorisation and, as appropriate, the threshold for levying the outperformance commission are compatible with the investment strategy implemented for each class of units or shares and by adapting it to each class of units or shares where appropriate,

- State explicitly the residual risk specific to each unit or share – and not the hedging requirements (unless a full and permanent hedge is put in place to manage the risk associated with all the classes of units or shares).

1.3.6. Investment rules

Highlighting indicators aimed at reducing the risk level of the CIS

Where asset management companies consider that it is necessary to highlight the risk indicators, they shall provide simple explanations on their import and limits. They shall not suggest that these ratios or indicators allow managing the risks associated the investment strategy in a comprehensive manner. The risk indicators used shall be adapted to the management strategies implemented.

Recommendation:
The Autorité des Marchés Financiers recommends being particularly vigilant as regards the risk indicators based on historical data and/or on volatility (VaR, Sharpe ratio), given the fact that they cannot help limit the risks entailed under unusual market conditions or under market conditions never met before.
Similarly, it may be avoided to set a target VaR if the fund implements hedging strategies whose risks are not being properly assessed by the VaR. If the asset management company considers that it is nonetheless relevant to provide this piece of information, it is recommended to supplement it with information on the arrangements made to manage the risk of major losses.

Information on the overall risk

It is reminded that the following information on the overall risk shall feature in the prospectus[11]:
- The method chosen by the asset management company between the commitment calculation method (the new name for the linear method) and the absolute or relative VaR approach;
- The estimated level of leverage of the fund, calculated as the sum of the nominal values of the positions in the financial contracts used when the VaR approach is used.
If the VaR method is used, information on the composition of the reference portfolio shall be detailed.

It is also recalled that Article 11 of the AMF instruction 2011-15 stipulates the specific information that needs to be included in the prospectus in the case of structured funds meeting the requirements of Article 411-80 of the AMF General Regulation.

1.3.7. Guarantee

Asset management companies shall ensure that the guarantor has the legal status to act as such. They shall also ensure that the contract terms of the guarantee do not allow the guarantor to walk away from its commitment, should unfavourable market conditions emerge or should operating risks linked to the management materialise for instance. Only the impact of an unfavourable development of the environment ((legislative or regulatory changes, tax change or bankruptcy) may be considered as sufficient grounds for evading this obligation.

1.3.8. Subscription and redemption procedures

Publication of the net asset value

The prospectus[12] identifies precisely the reference schedule for the publication of the net asset value of the units or shares in the CIS or real estate fund, even when it is a stock exchange timetable.
The schedule chosen for the publication of the net asset value allows investors to know a priori and in a non-arbitrary fashion the publication dates of the net asset value on which it is possible to purchase or redeem units or shares in the CIS or real estate fund.

[11] Or the regulation for approved private equity funds and the regulation or bylaws for employee savings fund s.
[12] Or the regulation for approved private equity funds and the regulation or bylaws for employee savings fund s.

Pursuant to Articles 411-123 and 242-66 of the AMF General Regulation: *"Once the net asset value has been published, subscriptions and redemptions of CIS units or shares shall be carried out on the basis of this value".*

This makes it impossible to implement a gate mechanism[13], which allows the CIS to defer the payment of all or part of the redemption requests when they exceed a certain threshold of the fund's net assets.

Suspension of the issuance of units or shares in the CIS

Pursuant to Article 411-20 of the AMF General Regulation: *'the prospectus defines objective conditions that trigger a temporary or definitive closure of subscriptions, such as reaching a maximum number of units or shares to be issued, a maximum amount of assets or the end of a given subscription period."*[14]

Recommendation:

In this particular case, it is recommended that the prospectus indicates accurately and explicitly the following:

- The conditions and arrangements for suspending, and potentially resuming, the issuance of units or shares in the CIS,
- The conditions under which investors shall be informed about the suspension and resumption of the issuance of units or shares in the CIS. For this purpose, the prospectus may provide for disseminating a press release in a national economic newspaper.

Investors in the fund may be provided with customised information.

As regards the arrangements for suspending or resuming the issuance of units or shares in the CIS, it is also recommended to:

- suspend the issuance of the units as quickly as possible after the end of the period dedicated to centralising the subscription or redemption orders. This gives rise to the publication of the last net asset value on which subscriptions are accepted and which corresponds to the moment when one of the requirements laid down in the prospectus is met. This helps avoiding, on the one hand, that investors who are aware the fund is soon to reach its term take advantage of the situation to subscribe for units in the fund and, on the other hand, that orders placed on the future net asset values be cancelled;
- ensure that the conditions laid down in the prospectus under which the CIS or the real estate fund resumes the issuance of its units or shares are not such as to trigger a succession of periods of suspension and resumption of the issuance within a short period of time.
- provide for a notice period applicable to the resumption of the issuance of units or shares in the CIS or real estate fund in the prospectus. This notice period may not be less than one month or exceed three month for CIS. It is extended to six months for real estate funds.

Approved CIS reserved for specific investors (ARIA funds and alternative funds of funds)

The arrangements for subscribing to or redeeming units or shares in ARIA funds and in alternative funds of funds are provided for in the AMF position 2006-18 on the deadline for calculating the net asset values of ARIA funds and alternative funds of funds.

Market timing and Late trading

The arrangements for subscribing to or redeeming units or shares comply with the principles set out in the AMF position 2004-07 on the practices of market timing and late trading.

[13] Except for collectives investment funds reserved for specific investors (with less stringent investment rules) and real estate funds.

[14] For real estate funds, these provisions are governed by Articles 424-11 and 424-12 of the AMF General Regulation.