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AMF Position - recommendation
A guide to the monitoring of collective investment schemes – DOC-2011-25

Background regulations: Articles L. 214-3, L. 214-15, L. 214-7-4, L. 214-24-15, R. 214-15, R. 214-32-23, R. 214-15-1, R. 214-16, R. 214-22 and D.214-22-1, D. 214-5, D. 214-32-12, D. 214-32-15, D.214-32-31 of the Monetary and Financial Code, Articles 311-1, 314-3, 314-12, 316-3, 319-13, 411-6, 411-10, 411-14, 411-20, 411-74, 411-75, 411-76, 411-77, 411-78, 411-79, 411-80, 411-9, 422-7, 422-11, 422-15, 422-21, 422-53, 422-54, 422-55, 422-56, 422-57, 422-58 and 422-59 of the AMF General Regulation.

When monitoring collective investment schemes (CISs), the *Autorité des Marchés Financiers* ensures that the operating conditions and management strategies of the CISs and real estate funds comply with their regulatory documents and with the applicable legislative and regulatory provisions. This monitoring process is distinct from the controls and investigations which can be carried out by the AMF concurrently.
In this context, the document:
- Recalls certain regulatory provisions applicable and indicates how they shall be interpreted;
- Sets out recommendations for applying them;
- Gives concrete examples of UCITS and non-UCITS.

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. This document is being updated on a regular basis.

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

1. Control procedures

Scope: CISs

1.1. Adequacy between the programme of operations and the financial instruments used

Pursuant to Articles 311-1 and 316-3of the AMF General Regulation, the file shall include *"a programme of operations for each of the services that the asset management company intends to provide, specifying the conditions in which it expects to provide those services and indicating the type of transactions envisaged and its organisational structure"*. Moreover, Article 6 of Chapter II, Title 1 of Instruction 2008-03[1] stipulates that the programme of operations *"is adapted to both the portfolios managed and the instruments used as part of the management strategy implemented by the company (…)."*
It is the duty of the portfolio management company to ensure that the type of financial instruments used is consistent with the management strategies implemented on the first hand, and that its organisational structure is adapted to the means at its disposal on the other hand. Peculiar attention must be paid to the ability of the portfolio management company to identify the risks linked to the financial instruments used and the strategies implemented and to value these financial instruments in an independent and accurate manner. In particular, the analysis cannot possibly rely only on the legal characterisation (equities, bonds) of the securities acquired.

For instance, a portfolio management company whose programme of operations restricts itself to describing the procedures for using listed financial instruments and simple futures financial instruments cannot use exotic options or structured products containing derivatives (like complex EMTN or structured certificates) when managing its funds if it fails to describe the means necessary to operate this activity in the programme of operations. Conversely, the asset management company can update its programme of operations, pending prior approval by the *Autorité des Marchés Financiers*, so as to acquire the right to conduct such activities.

[1] Instruction 2008-03 dated February 8, 2008 on the approval procedures and on the programme of operations of asset management companies and investment service providers offering portfolio management services on behalf of third parties and on an ancillary basis

Derivatives on hedge fund indexes

CISs are entitled to use derivatives on hedge fund indexes, provided that the programme of operations of the asset management company qualifies for the use of financial contracts, also referred to as “financial futures instruments.”

Using this option requires the asset management company to control that the index complies with the criteria according to which it can be characterised as a financial index, pursuant to Article R. 214-16 of the Monetary and Financial Code. In this context, the asset management company must check in collaboration with the *Autorité des Marchés Financiers* that it has the required organisational structure, human and technical means to operate as an “alternative fund of funds.”

Finally, it is recalled that the key investor information document and the fund’s prospectus[2] must provide accurate information.

1.2. Due diligence to be conducted in the event of a merger between a UCITS and other collective investment schemes

Scope: UCITS

Pursuant to article 411-3 of the AMF General Regulation, a UCITS cannot transform itself into a different collective investment scheme and cannot possibly undergo a transformation having equivalent effects. Accordingly, it is excluded that a UCITS be split, being replaced by a UCITS and a different collective investment scheme[3].

However, a UCITS may merge with a different UCITS or another collective investment scheme.

If the disappearing fund is a UCITS, the asset management company shall ensure, prior to the merger, that the countries in which the disappearing UCITS is marketed are the same as the countries in which the receiving UCITS is marketed.

1.3. Due diligence to be conducted when using financial contracts the underlying of which is a real estate index

Scope: CISs

In order to be declared as underlying assets eligible to the financial contracts (or financial futures instruments) entered into by a CIS, financial indexes must meet the requirements set out in I of Article R214-16 and in II of Article R.214-22 of the Monetary and Financial Code on the composition and representativeness of the index and on its mode of dissemination. Amongst financial indexes can be found indexes related to yearly-completed real estate transactions completed in a country, a geographical region or a given sector. Besides, in order to meet its valuation obligation, the asset management company is required to assess the depth and efficiency of the market for the financial contracts linked to the index chosen.

Consequently, this means that the asset management company must address both the issue of the index eligibility to the asset of a real estate fund and also the depth and efficiency of the market to which it refers.

Moreover, asset management companies are reminded that they must check whether or not using these instruments is compliant with the programme of operations approved by the AMF before they start using them.

Index-tracking UCITS comply with AMF Position DOC-2013-06 – Exchange-traded funds and other UCITS issues

[2] Or the simplified prospectus for funds which do not feature in the key investor information document yet.

[3] Excluding the specific regime governing side-pocket funds

1.4. Due diligence to be conducted when introducing gates in real estate funds, professional real estate funds, professional investment funds, and funds of alternative funds

Introducing gates allows deferring the subscription orders on the basis of several net asset values as soon as they exceed a certain threshold, determined in an objective manner.

Passive management must be compatible with the gates introduced. In that respect, before they implement the gates, asset management companies are required to contact their depository and the concerned service providers in order to check the compatibility of the contemplated scheme, both as regards flow processing and the information provided to investors.

1.4.1 Description in the prospectus

The functioning of the gates must be described accurately in the prospectuses of the AIFs concerned.

1.4.2 The method chosen

The method chosen shall be consistent with the structure of the fund’s assets and liabilities.
It is necessary that the threshold above which gates may be activated is not such as to undermine the open nature of the AIFs concerned.

In the case of a professional investment fund or fund of alternative funds whose net asset value is fixed on a monthly basis, this requirement is considered to be complied with when the threshold is not lower than 10% of its net assets. Moreover, asset management companies shall determine the periodicity for calculating the net asset value when the professional investment fund or the fund of alternative funds uses a gate mechanism. Indeed, while it is possible to introduce gates amounting to 10% of the net assets with a net asset value calculated on a monthly basis, it is impossible to introduce a gate amounting to 0.5% of each daily net asset value as it would result in the professional investment fund or fund of alternative funds losing its open nature.

In the case of real estate funds, excluding professional real estate funds, gating thresholds should enable holders to be repaid at at least 2% of the fund's net assets every month, and redemption requests should be executed and settled within one year at most from receipt of the order, including notice periods. This gate threshold is possible only for a real estate fund whose documentation explicitly refers to the illiquid nature of its units or shares.

The level of non-executed orders shall be determined after the end of the period dedicated to centralising the orders. This meets the need to inform the concerned investors at the earliest opportunity and aims to give them the possibility to submit, in compliance with the notice deadlines and if they want to, a new order for the fraction of non-executed orders (see item on the execution of orders).

The trigger threshold of the gates is calculated on the basis of the amount of redemptions, minus the amount of subscriptions.

- Real estate funds (OPCI)/Professional investment funds/Funds of alternative funds offering only one category of units:

For such AIFs or real estate funds, the threshold at which the gate is triggered is calculated at the end of the period dedicated to centralising the orders by bringing back the number of redemptions minus the number of subscriptions, expressed in terms of shares, to the total number of units of the fund’s latest net asset value. The threshold may also be measured in amounts under the following conditions.

- Real estate funds (OPCI)/Professional investment funds/Funds of alternative funds offering several categories of units:

AIFs can set different thresholds for triggering the gate depending on the categories of units.

For AIFs of this type, the threshold at which the gate is triggered is measured at the end of the period dedicated to centralising the orders. The redemptions, minus subscriptions, expressed in amounts (number of units multiplied by the latest net asset value), are brought back to the net assets of the fund's net asset value.
If indicative net asset values have been calculated previously, they can be endorsed. Overall, the asset management company shall make the necessary adjustments to determine the reference net assets on the basis of the information it was provided with since the net asset value was last calculated.
The net asset values used for net redemptions (numerator) expressed in amounts are those related to the net assets used in the calculation (denominator).
Back-and-forth transactions, for a same number of units and executed on the basis of the same net asset value and by a single investor or beneficial owner, are not included in the calculation of the gates. They may escape being fractionated insofar as the prospectus provides for it. This provision allows avoiding that an investor who completes a back-and-forth transaction has its redemption order fractionated while a subscription order of a similar amount offsets the impact of this redemption order on the AIF.

1.4.3 Procedures for triggering the gates

The asset management company is free to trigger the gate mechanism, as provided for in the prospectus. Before it makes this decision, it shall ensure that the principle of investors' fair treatment is being complied with. It must act in the interest of the remaining investors and avoid the risks of conflicts of interests.

The decision of triggering the gates shall only be made in the interest of the remaining investors. The gates shall not be negotiable by investors submitting orders on the basis of a unique net asset value. Should the asset management company decide not to trigger the gates for a net asset value, the decision shall be documented and held at the AMF's disposal.

1.4.4 Order execution

Orders exceeding the level at which the gate is triggered are not executed. The rules governing the reduction of orders must ensure that investors leaving the fund are treated fairly. Reducing the orders to the same extent for all investors is usually the most appropriate mechanism. However, it shall be adapted to suit certain complex gate mechanisms such as the schemes under which the orders placed within a certain threshold are executed first and the number of orders exceeding that threshold are reduced in order to meet the gate requirements. Asset management companies may potentially be required to adapt the characteristics of the fund's units so as to allow partial execution, either by reducing the value of the units or by fractionating them.

Moreover, asset management companies shall determine and specify in the prospectus of the AIF if the non-executed orders will be cancelled or deferred and executed on the basis of the following net asset value.
This point shall be assessed in the light of the liquidity management overall scheme, and more particularly by taking into consideration the consequences resulting from systematically deferring the orders that would help maintain systematic demand for redeeming units in the AIF concerned. Asset management companies shall also assess the fact that introducing a scheme under which orders are automatically deferred incites investors to anticipate their redemption requests in order to secure a place in the waiting line. As regards this peculiar issue, they shall ensure, together with the relevant market participants (depositaries, centralist,…), that the scheme can be operated.

Where the scheme depends on non-executed orders being deferred and executed on the basis of the following net asset value, deferred orders have no priority over the new redemption orders to be executed on the basis of the current net asset value. Should redemption orders be fractionated once again on the basis of the current net asset value, they shall be fractionated under the same conditions as the new subscription orders. This principle allows once again avoiding that investors who wish to leave the AIF be penalised by redemption orders previously submitted by other investors. It also helps reduce the risk that investors be tempted to anticipate their redemptions orders to secure a place in the waiting line.

Given the necessity to submit orders once again or to defer them, asset management companies are required to determine a periodicity for determining the net asset value and notice periods which allow investors to submit their orders again. Asset management companies cannot possibly escape their obligation to inform investors about the mandatory notice periods. The asset management companies shall provide for arrangements for identifying the deferred orders or the orders that were submitted again in accordance with the mandatory notice period. Investors shall not be penalised by being prevented from deferring their orders or submitting them again on the basis of the following net asset value.
Indeed, it is necessary to comply with this schedule in order to be able to initiate the transactions in the AIF's net assets in a timely manner (the underlying hedge funds for instance).

Introducing gates can prove to be a sensitive issue, for operating reasons, when the frequency for setting the net asset value is high (a daily or weekly frequency for instance).

1.4.5 Order cancellation

The asset management company shall ensure that orders submitted prior to the order centralisation date cannot possibly be changed, including through cancellation requests which could be assimilated to late trading operations. Moreover, the asset management company shall not give any details on the level of the subscription and redemption orders placed that would have an investor anticipate whether the gate is likely to be triggered or not.

1.4.6 Investor information

In the event of cancellation, investors of whom a fraction of orders has not been executed shall be informed of it within timeframes allowing them to submit the non-executed orders on the basis of the next net asset value. The procedures for informing investors are provided for in the AIF's prospectus.

2. Managing CISs reaching maturity

2.1. Managing the fund in the investors' interest and minimum amount of assets under management

Scope: UCITS/Retail investment funds/Private equity funds/Funds of alternative funds/Professional investment funds/Declared funds

The minimum amount of assets under management provided for in the regulation is low: it stands at €300,000 for collective investment schemes and open-end investment companies (SICAV)[4]. Many management strategies require a higher minimum amount of assets under management in order to be implemented in the interest of the investors. It is the duty of the asset management company or CIS to make the necessary arrangements for:
- identifying the situations under which the fund's net assets are likely to become too low for the fund to be managed in the interest of the investors;
- defining and implementing measures aimed at ensuring that the fund is managed in the interest of the investors: looking for new subscriptions to preserve the fund's net assets at a sufficient level, transformation, mergers or winding-ups if it is impossible to preserve the fund's net assets at a sufficient level.

Accordingly, it is not acceptable to wait systematically that the fund's net assets fall below the minimum amount of assets under management to implement corrective measures. The decisions on the future of a CIS shall be exclusively made in the investors' interest and shall by no means give precedence to the interest of the asset management company over that of the investors.

[4] Except for dedicated funds (Article 422-94 of the AMF General Regulation) and formula funds (Articles 411-21, paragraph 4 and Article 422-22, paragraph 4 of the AMF General Regulation).

An asset management company notes that the fund's net assets are decreasing on a regular basis and that they will inevitably fall below the €300,000 minimum amount of assets under management.
It believes that the fund has no commercial future and that is must consequently be liquidated. However, it considers that the fund can still be managed despite the decline in its net assets. The asset management company does not want to be seen as the party which initiates the fund's liquidation, fearing this will undermine its image amongst its clients. Accordingly, it decides to wait for the fund's net assets to fall below the €300,000 minimum amount of assets under management and stay below this threshold for more than 30 days before making the decision to liquidate the fund.
This allows the asset management company to present its decision to its clients as the direct consequence of a regulatory provision and not as a decision of its own.
This method is not compliant with the regulation because:
- It leads the asset management company to give precedence to its own interest (its image amongst customers) over that of the investors in the fund (who, on the one hand, invest in a fund which is soon to be liquidated without knowing it and, on the other hand, will suffer the consequences of the fund's liquidation when submitting their redemption requests in the next few weeks);
- The information provided to investors is not "clear, accurate and non-misleading" since it presents the fund's liquidation as the consequence of a regulatory provision while it is in fact a decision of the asset management company itself.
Moreover, it is recalled that the management strategy implemented by the CIS shall be consistent with the strategy described in the prospectus in all circumstances. The fact that the fund's net assets make it no longer possible to implement the management strategy shall prompt the asset management company or the fund to ask themselves why they failed to anticipate the situation and to take all the necessary corrective measures.
It does not justify implementing a management strategy that would not be consistent with that defined in the prospectus.

The management strategy implemented by a European Union Equity fund requires that the fund's net assets are at least €10 million. The fund is almost exclusively held by a life-insurance company which marketed it to its clients in the form of unit-linked life insurance contracts. The life-insurance company decides to create units in the fund, which results in the capital of the fund being greatly reduced, though remaining above the €300,000 minimum amount of assets under management. The asset management company notes that the fund has no future and that outflows from the fund continue. It decides to have the fund invested in monetary assets until its assets under management fall below €300,000 and then liquidate it. The asset management company fails to inform the remaining investors about this decision and about the change in the management strategy. This method is not compliant with the regulation insofar as:
- The way the fund is managed is not consistent with the content of the prospectus;
- The information provided to investors is not "clear, accurate, and non-misleading".

If the fund's medium-term sustainability is not undermined and if the management strategy is in the interest of the current or future investors, the 30-day period provided for in the regulation can be used to secure new subscriptions.
Conversely, if the fund's medium-term sustainability is undermined, or if the management strategy proposed by the fund is not intended to be continued, the fund can file for transfer (liquidation, merger, demerger or absorption) with the *Autorité des Marchés Financiers* before the end of the 30-day notice period. Pursuant to Articles 411-21 and 422-22of the AMF General Regulation, the transfer process becomes mandatory when the net assets have remained for 30 days below the fund's minimum amount of assets under management.
- Blocking redemptions when the fund's assets fall below the minimum amount of assets under management
After it saw some funds file for liquidation because their assets had fallen below the minimum amount of assets under management, the *Autorité des Marchés Financiers* realised that not all service providers had established a unique organisational structure suited to ensure that the provisions of Articles 411-21 and 411-22 of the AMF General Regulation are being complied with.
Accordingly, the *Autorité des Marchés Financiers* reminds that the redemption of units or shares shall be blocked as soon as measuring the fund's net assets reveals that the latest movements in the fund's

assets or liabilities have resulted in the fund's assets falling below the regulatory minimum amount of assets under management.

The asset management company of a collective investment scheme whose net assets stood at €350,000 when the net asset value was last calculated and falls to €280,000 when calculating the new net asset value shall not execute any redemption orders as of this date.

Moreover, considering the impact of the fund's assets falling below the regulatory minimum amount of assets under management on investors (which results in redemption orders being blocked), the asset management company shall take all the necessary steps to anticipate such situations as much as possible and to minimise the impact on investors.

The assets of an open-end investment company (SICAV) decrease on a regular basis and are likely to fall below the €300,000 minimum amount of assets under management. The asset management company waits for the assets to fall below this threshold to start thinking about the measures to be taken in collaboration with the SICAV's management. It may take several weeks to consider the different steps to be taken (merger, liquidation, resuming subscriptions) and to implement them (approval by the *Autorité des Marchés Financiers*, calling for an extraordinary general meeting). Investors consequently have their redemption orders blocked for several months. This situation is not compliant with the regulation. The necessary steps shall be taken to shorten the period during which redemption orders are blocked.

Failure to comply with the aforementioned principles led some asset management companies to offer business courtesies to the fund or investors harmed in order to compensate for their loss when they had their redemption orders blocked for a long period of time.

2.2. Executing significant redemptions orders, in particular when the CIS is close to the regulatory threshold

Scope: CISs

When the asset management company or the CIS receives redemption orders accounting for a significant proportion of the fund's liabilities and which could result in the fund falling below the minimum amount of assets under management, it shall ensure that meeting its obligation to execute orders so as to avoid that executing redemption orders leads to unfair treatment between investors who submitted a redemption order and the investors who retained their units (or shares) does not undermine its ability to manage the fund in the interest of the remaining investors.

Accordingly, an asset management company who would receive a redemption order accounting for 60% of the fund's net assets, valued at €1,200,000, should ensure that it is still able to manage the fund despite the sharp decline in the fund's net assets. Should it become incapable of managing the fund in such circumstances, the asset management company can, pursuant to Article L.214-7-4 or L214-8-7 of the Monetary and Financial Code, suspend redemptions in the investors' interest. It shall then make the necessary decisions in a timely manner to resume redemptions or liquidate the fund.

Finally, if the redemption orders concerned are submitted by an entity linked to the asset management company or to a significant client, particular attention must be paid to identifying and addressing the conflicts of interests arising from this situation.

An investor (a subsidiary of the asset management company) holding 50% of the fund's assets asks for its units to be redeemed. The asset management company knows that executing this order would have the fund fall below the minimum amount of assets under management. In this context, it must take the necessary steps to ensure that the exit of this investor does not penalise the remaining investors.

2.3. Organising the fund's liquidation

Scope: CISs

As soon as it is decided that the fund will be liquidated and that the conditions for the assets to be realised require a change in the investment policy, the decision must be communicated to investors on the same day the liquidation is announced. This decision shall first be approved by the AMF when the fund files for transfer.

Moreover, it shall be highlighted that selectively informing certain investors that the assets might drop below the minimum amount of assets under management is a breach of the obligation to treat unit holders or shareholders fairly such as to engage the liability of the asset management company or CIS. The orderly liquidation of the CIS, whether it is decided by the asset management company or by the management of the fund, is most of the time a solution which reduces litigation risks.

The asset management company informs the two biggest investors in the fund, which, taken together, account for more than 50% of the fund's assets, that the assets of the collective investment scheme are getting close to €300,000. The two investors submit redemption orders which result in the fund falling below the €300,000 threshold. This practice is not compliant with the regulation since the asset management company communicates the information to a reduced number of investors who are able to exit from the fund while those who have not been informed have their investment in the fund blocked until the asset management company makes a decision on the future of the fund.

2.4. Valuation rules

Scope: CISs

In the event of outflows from the fund, it is important that the methods for valuing the assets of the CIS be clearly defined so that investors can exit from the fund on the basis of a net asset value which reflects market reality.
The asset management company or the CIS shall ensure, under such circumstances, and more particularly in the event of important outflows from the fund, that the on-balance and off-balance positions are sold or unwound respectively, under terms compatible with the principles for valuing the fund's assets. Indeed, inadequacy between the price at which the assets are sold and the valuation conditions means that the remaining investors are likely to suffer the consequences of limited or increased exposures to the market when they unwind their positions, which may ultimately have major impacts on the fund's net asset value.

Where a CIS which replicates the CAC 40 index receives redemption orders amounting to 95% of its assets and if a spread of 1% is recorded between the price at which fund's assets are valued and the price at which they are sold, this difference will be passed onto the investors who hold the remaining 5% of the assets. This means that the impact on these investors will be 20 times higher than the impact of the market variation. The initial spread of 1% will have an impact of 20% on the remaining investors.

3. Side pocket funds

Pursuant to Article L. 214-8-7 or Article L. 214-24-41 of the Monetary and Financial Code the demerger of UCITS/retail investment funds/private equity funds/funds of alternative funds/professional retail funds/ professional specialised funds/professional private equity funds/employee investment funds gives rise to two CISs. The first is dedicated to receive the assets the sale of which do not serve the investors' interest (side pocket funds) and the other is meant to receive the other assets of the split fund (replicated fund).

These types of demergers are intended to confront an exceptional situation that undermines the value of some of the fund's assets. Accordingly, deciding to create a side pocket alternative investment fund shall remain exceptional and concern only certain identified assets.

Recommendation:

Prior to the creation of the side pocket fund, it is recommended that the CIS or the asset management company contact the *Autorité des Marchés Financiers* in order to draft the statement to be communicated to the AMF and write the information to be provided to investors in the fund.

3.1. Shall the replicated fund be approved by the AMF?

Articles L. 214-8-7 and L. 214-24-41 of the Monetary and Financial Code provides that the split fund need not be approved by the AMF but shall be immediately notified to it.
Consequently, provided that only the absence of the assets transferred to the side pocket fund distinguishes the assets of the replicated fund from those of the split fund, the replicated fund born out of the demerger shall not file for approval again with the AMF insofar as it benefits from the accreditation of the split fund.
Conversely, if the replicated fund demonstrates other differences with the split fund in its investment strategy or in the way in which it operates, it shall be subject to the applicable rules governing the transformation of CIS, in particular as regards the information to be provided to investors, the right of investors to exit free of charge or the procedures to be followed to be granted approval by the AMF.

3.2. Notification to the AMF: content and procedures

Demergers decided pursuant to Article L. 214-8-7 or Article L. 214-24-41 of the Monetary and Financial Code shall be immediately notified to the AMF.

This notification shall include:
- A copy of the demerger decision: the minutes of the extraordinary general meeting of the open-end investment company (SICAV) to be demerged or the copy of the decision of the asset management company which manages the collective investment scheme to be demerged;
- The list of the assets transferred to the side pocket fund;
- A technical note justifying the volume of the assets transferred to the side pocket fund;
- The report justifying and detailing the terms of the demerger decision, which shall be transmitted to investors, pursuant to Articles D. 214-5, D. 214-8, D. 214-32-12 and D. 214-32-15 of the Monetary and Financial Code;
- The full prospectuses of the replicated fund and side pocket fund;
- The mails and documents intended to inform investors about the demerger, whatever the mode of communication chosen;
- The fund deposit certificates of the two funds that were born out of the demerger.

This notification shall be communicated to the AMF by email or mail.

This notification is deemed filing with the AMF for the creation of a side pocket fund, which shall be necessarily incorporated as a professional specialised fund.

This declaration does not exempt the concerned CIS or the asset management companies managing the fund from complying with the formalities required for demergers or for the creation of a CIS (Euroclear formalities, declaration at the court registry, etc.)

Finally, the statutory auditors' report is communicated to the AMF as soon as it is drafted.

3.3. Procedures for informing investors

Articles D. 214-5, D. 214-8, D. 214-32-12 et D. 214-32-15 of the Monetary and Financial Code provide that investors in the split fund be immediately informed about the demerger by the split fund or its asset management company and that the rationale and procedures for the demerger and be transmitted to them.

This information, which is of particular nature, needs to be communicated individually to all investors. It can be supplemented with general information, which can be disseminated through a news release for instance.

Articles D. 214-5, D. 214-8, D. 214-32-12 et D. 214-32-15 of the Monetary and Financial Code also advocate that the split fund or the asset management company provide investors with prospectuses and, where applicable, the Key Investor Information Documents for the two CISs born out of the demerger:

Mail intended to inform investors about the realisation of the demerger shall indicate how they can have access to these documents or how they can obtain them upon request.

In addition to the aforementioned procedures for informing investors, the split open-end investment company or its asset management company shall also comply with the provisions set out in Articles 422-98 et seq. of the AMF General Regulation on the procedures to be followed in the event of demergers involving CISs.

3.4. Which assets can be transferred to a side pocket fund?

Since Articles L. 214-8-7 and L. 214-24-41 of the Monetary and Financial Code does not provide for any limitation in respect of the legal nature of the assets that can be transferred to a side pocket fund, all assets whose sale would not be in the interest of the investors in the split fund may, a priori, be transferred to a side pocket fund.

It is the duty of the split fund or asset management company managing the fund to list the assets which must be transferred to the side pocket fund. However, it bears recalling that the decision to create a side pocket fund shall remain exceptional and concern only certain identified assets. Accordingly, mere difficulty in valuing or selling certain assets may not lead to think that selling them would not be in the interest of the investors.

Moreover, the split fund or the asset management company shall ensure that:
- The contemplated demerger is possible given the particular circumstances of the fund. The existence of frame agreements or prime brokerage agreements entered into by the CIS soon-to-be demerged or the creation of collaterals by this CIS can be obstacles to completing the demerger;
- The assets to be transferred to the side pocket fund are eligible for such a transfer. Indeed, the transfer of certain types of assets may be subject to conditions such as the agreement of a contractual partner (for over-the-counter financial futures instruments for instance).

3.5. What is run-off management?

Articles D. 214-5, D. 214-8, D. 214-32-12 and D. 214-32-15 of the Monetary and Financial Code provide that side pocket funds be managed in a run-off mode. This means that:

- Any type of active management is prohibited. Only the management acts aimed at protecting the interest of the investors and at ensuring that the fund’s liquidation is completed in the best possible conditions are authorised;
- The number of units or shares in a side pocket fund is determined when the fund is demerged and it remains the same until full liquidation of the fund. Indeed, the side pocket fund is not allowed to issue new units or shares and it shall not honour any redemption requests. However, it gradually depreciates the existing units or shares in compliance with the principle of investors’ fair treatment.

When the split fund or its asset management company considers that selling the assets transferred to the side pocket fund is in the interest of the investors again, the said assets can be sold. The depreciation of the units or shares in the side pocket fund can then be realised immediately or subsequently. It requires the side pocket fund to ensure that it has the liquidities necessary to run off its assets (so as to honour margin calls for instance).
Moreover, market conditions or the interest of investors in the side pocket fund may lead to certain assets being sold at maturity only.

3.6. What does the legal nature of the replicated fund and split fund, provided for in Articles D. 214-5, D. 214-8, D. 214-32-12 and D. 214-32-15 of the Monetary and Financial Code, imply?

The replicated fund must have the same legal nature, investment rules and operating rules as the split fund. For instance, the replicated fund born out of the demerger of a generalist open-end investment company shall be a generalist open-end investment company. Similarly, the replicated fund born out of the demerger of professional investment fund shall be a professional investment fund, etc.

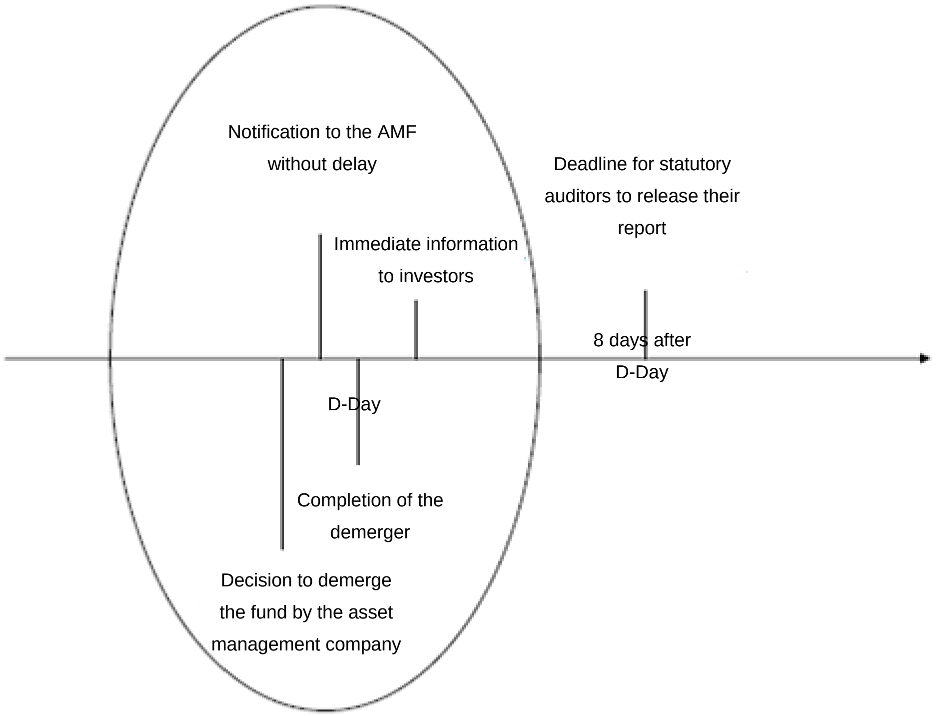
However, the side pocket fund always comes in the form of a professional specialised fund, pursuant to Articles D. 214-5, D. 214-8, D. 214-32-12 and D. 214-32-15 of the Monetary and Financial Code.

3.7. Why do demergers of collective investment schemes qualify for a specific regime?

All demergers of open-end investment companies or collective investment schemes decided pursuant to Articles L. 214-7-4, L. 214-8-7, L. 214-24-33 or L. 214-24-41 of the Monetary and Financial Code qualify for a less stringent regime insofar as they are not subject to approval by the *Autorité des Marchés Financiers* but only need to be notified to it.

However, only the regime governing demergers of collective investment schemes was set up by Decree 2008-1312 dated December 12, 2008. For their part, open-end investment companies are still governed by common law rules on demergers of public limited liability companies and simplified public limited companies provided for in the Commercial Code. Accordingly, demergers of open-end investment companies remain governed by the existing regime, as set out in Articles 412-5 and onwards and Articles 422-98 and onwards of the AMF General Regulation.

Chronology of a collective investment scheme demerger decided pursuant to Article L. 214-8-7 or Article L. 214-24-41 of the Monetary and Financial Code:



Transactions which can be completed without delay

3.8. Are instructions 2011-19 and 2011-20 applicable in the event of a merger decided pursuant to the second paragraph of Article L. 214-8-7 or the second paragraph of Article L. 214-24-41 of the Monetary and Financial Code?

Yes. Instructions 2011-19 and 2011-20 specify the applicable procedure.

3.9. Does a demerger decided pursuant to Article L. 214-8-7 or Article L. 214-24-41 of the Monetary and Financial Code give investors in the split fund the right to exit free of charge?

No. A demerger decided pursuant to Articles L. 214-7-4, L. 214-8-7, L. 214-24-33 or L. 214-24-41 of the Monetary and Financial Code does not induce substantial changes in the rights of investors insofar as investors in the split fund become investors in the two funds born out of the demerger which, brought together, combine the rights they had in the single CIS before.

3.10. Can the replicated fund be marketed?

Yes. The marketing conditions of the replicated fund are identical to those of the split fund.

3.11. Can past performances of the split fund be mentioned in the documents (prospectus, marketing materials, etc.) of the replicated fund?

First of all, it should be highlighted that the replicated fund is allowed to create a performance history as of its incorporation date only and that it is not allowed to use the performance history of the split fund or to link, in any way, its own performance history to that of the split fund.

However, given the specific character of the demerger that led to the creation of the replicated fund, it may be allowed that the documents (prospectus, marketing materials, etc.) of the replicated fund mention the performance history of the split fund, provided that they clearly indicate that:
- The performance history is not that of the replicated fund,
- The replicated fund was born out of the demerger, which was decided so as to create a side pocket fund out of the CIS of which the performance history is presented.

3.12. Can a side pocket fund be transformed, merged or demerged?

Although the transformation, merger or demerger of a side pocket fund, necessarily incorporated in the form of a professional specialised fund, is not explicitly prohibited by Law, the fact that it must be managed in a run-off mode precludes a priori that it be subject to such mutation.

If a side pocket fund were to be exceptionally merged or demerged, this transformation should be justified by considerations specific to the management of a side pocket fund.

4. Compensation procedure

Scope: CISs

Professionals may opt for compensation solutions, short of a tort action in court. The *Autorité des Marchés Financiers* encourages the concerned professionals to compensate the investors who might have been harmed by their failure to fulfil their duties, yet without imposing any obligation in this matter.

The AMF has no jurisdiction to deal with compensation for the damage suffered by investors in a CIS. However, it wishes to be informed by the concerned professionals about the steps taken in the event of compensation.

4.1. Impact analysis

An asset management company may decide to provide financial compensation for the damage suffered by investors in a collective investment scheme

The damage suffered by investors can, for instance, be the result of valuation or management errors or of failure to comply with the provisions set out in the prospectus, etc.

It is recommended that as soon as the asset management company becomes aware that investors in one of its CISs have suffered damage, it should contact the fund's statutory auditor, its depositary and the *Autorité des Marchés Financiers* to inform them about these events.

The asset management company will have to conduct an analysis detailing the following:

- The origin of the error, the period during which it was made and the steps taken by the asset management company to prevent this situation from reoccurring;
- The impact of the error on the CIS and on each investor (in amounts and percentage of the fund's net asset value);
- The corrective measures contemplated by the asset management company to repair the damage suffered and the potential threshold under which it considers the loss suffered too small to be compensated (the choice of the threshold shall be reasonable and determined by the asset management company, based on the nature of the fund, of the investors, etc.)

As part of the impact analysis, it is recommended that the asset management company take into account the changes in the minimum amount of assets under management during the concerned time period, re-calculate the fund's net asset value for the time period running from the origin of the mistake to the date at which the mistake was corrected and the damage suffered compensated and assess the significance of the impact. The asset management company shall also analyse the impact of these changes on the fund's performance over the aforementioned period.

Let’s take the example of a CIS of which the published net asset value is false (undervalued) due to a valuation error of a financial instrument in which the fund invested. In this context, investors who exited the fund or which retained their holding in the fund during the concerned time period suffered a loss and the fact that investors acquired units in the fund on the basis of a net asset value that was undervalued also caused the fund to suffer a loss. The asset management company is then required to take into consideration all these circumstances when calculating compensation.

As soon as a mistake has been identified, the asset management company may endeavour to compensate for the damage suffered by the fund or by the investors. Three situations have to be distinguished: compensation for the fund, compensation for those investors who subscribed for units in the fund and compensation for those who redeemed units in the fund.
- Compensation for the CIS: Such compensation can be approved in particular in the event of a loss or when investors subscribed for units on the basis of a wrong and lower net asset value, thereby yielding lower returns and causing the already existing investors to suffer a loss.
- Compensation for investors who have already subscribed for units in the fund on the basis of an overvalued net asset value.
- Compensation for investors who redeemed units in the fund on the basis of an undervalued net asset value. Since the asset management company is responsible for setting and publishing the net asset value, it cannot, in practice, require investors who subscribed for units on the basis of an undervalued net asset value to pay additional money to match the real net asset value nor can it return units redeemed on the basis of an overvalued net asset value.

The asset management company, and not the fund, shall bear the costs associated with the compensation scheme. Should the CIS partially bear the costs associated with a compensation scheme, the asset management company will have to prove that this is in the investors’ interest.

4.2. Settlement and compensation of the damage suffered

Once the impact analysis is completed, the asset management company is allowed to compensate the fund and investors in the fund.
In order to ensure proper record-keeping, the asset management company is required to provide the *Autorité des Marchés Financiers* with the following:

- The principles adopted as regards the method, calculation and efficiency of the compensation mechanism, supplemented with the assessment of the fund’s statutory auditor on these issues;
- The provisional timeframe for the compensation payments supplemented with the list of all the investors and intermediaries if possible;
- The information that will be provided to investors who suffered a loss.

5. Calculating exposure and overall risk

With the exception of the "short-term money market", "money market" and "formula fund" classifications referred to in Articles 30-7 and 30-8 of Instruction DOC-2011-19, Articles 30-7 and 30-9 of Instruction DOC-2011-20, Articles 30-7, 30-9, 30-10 and 30-11 of Instruction DOC-2011-21 and Annexes I.1 and III.1 of Instruction DOC-2012-06, the fund classifications referred to below shall be maintained only at the CIS's discretion[5].

For CISs that have elected to eliminate this classification or to not use a classification, all exposure and/or investment limits related to the abandoned classification must be included in the fund's regulatory documents. These limits must be respected at all times, whether they are derived from regulatory documents or management rules specific to the CIS.

CISs that refer to one of the classifications referenced in (i) Articles 30-1 to 30-6 of Instruction DOC-2011-19, (ii) Articles 30-1 to 30-6 and 30-8 of Instruction DOC 2011-20 and (iii) Articles 30-1 to 30-6 of Instruction DOC-2011-21 or (iv) Annexes I.1 and III.1 of Instruction DOC-2012-06 in their regulatory documents and that have elected to no longer use this classification will have to delete this reference from their regulatory documents.

CISs, including those established in 2017, may use the "Diversified" classification until 31 December 2017. This classification will be permanently eliminated after that date. These CISs will have to delete all references to this classification from their regulatory documents.

Lastly, CISs that decide to no longer use the classifications will be required, as soon as they abandon their classification, to enter one of the ECB classifications, as indicated below, on their GECO extranet for the purpose of reporting to the Banque de France under Regulation (EU) 1073/2013 concerning statistics on the assets and liabilities of investment funds:

Classification
Equity fund
Bond fund
Mixed fund
Real estate fund
Hedge fund
Other fund

5.1. Taking into account all financial instruments when calculating exposure

Scope: UCITS/Retail investment funds/Funds of alternative funds/Professional investment funds/Employee investment funds

Articles 30 et seq. of instruction DOC-2011-19, instruction DOC-2011-20 and instruction DOC-2011-21 define the different categories to which a CIS can belong. Belonging to a given category depends on several criteria, including most of the time an exposure criterion. Accordingly, a fund belonging to the "French equity" category must have exposure of at least 60% to the French equity market.

As provided for in Article 30-10 of instruction DOC-2011-19, Article 30-11 of instruction DOC-2011-20 and Article 30-12 of instruction DOC-2011-21, calculating the fund's exposure requires taking into account contractual transactions, financial contracts and securities with embedded derivatives in addition to physical investments. Since the purpose of segregating funds into different categories is to give an

[5] No action is required by the CIS to maintain the AMF classification.

overview of their sensitivity to the price movements in the different markets, it is necessary that the derivatives and securities with embedded derivatives in the fund's portfolio be taken into account on the basis of the value of their equivalent underlying ("delta").

In that respect, using a reverse certificate that would offer reverse exposure to the performance of an equity index would reduce overall exposure to the equity markets. Besides, it would be impossible to measure the contribution of this instrument to the exposure on the basis of its market value insofar as such a calculation would overlook the sensitivity of the instrument to the underlying market.

Moreover, it bears recalling that pursuant to Article 30-10 of instruction DOC-2011-19, Article 30-11 of instruction DOC-2011-20 and Article 30-12 of instruction DOC-2011-21, the units or shares in sub-funds held by the investor fund shall be accounted for in the calculation of the investor fund's exposure by taking into account their own categorisation.

For instance, a fund that would invest at least 70% of its assets in "French equities" funds and the remaining 30% in money market instruments, without using derivatives, would be considered as having an exposure of 70% to the French equities markets and would be classified as a "French equity" fund.

5.2. Compliance with the rules imposed by the categorisation or set out in the key investor information document (KIID) and in the prospectus

Scope: UCITS/Retail investment funds/Private equity funds (retail private equity investment funds, retail venture capital funds and retail local investment funds/Funds of alternative funds/Employee investment funds

Pursuant to Article 30 of instruction DOC-2011-19 and instruction DOC-2011-20, each CIS shall mention in its key investor information document (KIID) and in its prospectus the category to which it belongs and complies at all times with the criteria governing its category, set out respectively in Articles 30-1 and 30-09 of instruction DOC-2011-19 and Articles 30-1 to 30-10 of instruction DOC-2011-20.
The four "Equities" categories share the common feature of a minimum exposure requirement of 60% to the equity markets of a specific geographical region.
In order to ensure that the criteria governing the fund's category are complied with and to ensure coherence within this category, the *Autorité des Marchés Financiers* stipulates that Equity funds must have simultaneous exposures of 60% to the overall equity risk and of 60% to the equity risk linked to their geographical region.

Thus, for instance, a euro zone equity fund which would invest 60% of its assets in euro zone equities and reduce its exposure to the equity risk by selling Swiss equity futures would fail to comply with the criteria governing its category as its overall exposure to the equity markets would be lower than 60%.

The *Autorité des Marchés Financiers* further emphasises that it is possible to implement the type of management described in the preceding paragraph or to hedge against a decline in the equity markets in "diversified" funds. This category does not provide for any exposure limit and allows implementing "Long short equity" management strategies.
Lastly, it is recalled that all the exposure limits and/or investment limits set out in the prospectus, whether they arise from the categorisation or from investment rules specific to the fund, shall be complied with at all times.

Let's take the example of an "International equity fund" of which the prospectus mentions an exposure range to the equity markets, all geographical areas combined, of between 70% and 100%. The fact that the asset management company forecasts a decline in the equity markets does not give the fund the right to reduce its exposure to the equity markets to less than 70%.

5.3. Clarification of the definition of ancillary risk

Scope: UCITS/Retail investment funds/Private equity funds (retail private equity investment funds, retail venture capital funds and retail local investment funds/Funds of alternative funds/Professional investment funds/Professional specialised funds/Professional private equity investment funds

For certain categories, exposures to currency or market risks which differ from that of the concerned geographical zone shall remain ancillary. The *Autorité des Marchés Financiers* considers, in that respect, that any exposure to a specific risk exceeding 10% of the fund's assets cannot possibly be considered ancillary.
Accordingly, a fund with an exposure of more than 10% to US bonds cannot fall in the category "bonds and other euro-denominated debt securities".
Moreover, the notion of ancillary risk used in the prospectus shall reflect the marginal nature of the said exposure. The aforementioned 10% limit can prove inadequate for certain categories of funds or certain types of management. An exposure below 10% cannot be considered ancillary then.

Accordingly, a diversified fund which mainly invests in money market instruments and which has an exposure of 8% or 9% to the commodity markets in order to outperform cannot pretend that such exposure is ancillary insofar as it is a performance driver and entails a significant degree of risk for the fund.

Holding ancillary liquid assets

Scope: UCITS/Retail investment funds/Private equity funds/Funds of alternative funds/Professional investment funds/Declared funds/Employee investment funds

Holding ancillary liquid assets may be justified, for example, in the following cases:

- in order to cover current or exceptional payments;
- in the case of sales of the fund's assets, for the time necessary to reinvest in other financial instruments;
- for a period of time strictly necessary when, because of unfavourable market conditions, the investment in financial instruments must be suspended.

Pursuant to paragraph 5.3 of this Position-Recommendation, it is considered in this regard that any exposure to a specific risk exceeding 10% of the fund's assets could not be qualified as ancillary. Where exceptional market conditions justify it, however, it is considered that a CIS may increase this limit to 20% for liquid assets. In all cases involving UCITS, retail investment funds, professional investment funds, funds of alternative funds and employee investment funds, the liquid assets held, cumulated with the exposure to the factors mentioned in III of Article R. 214-21 and Article R. 214-32-29 of the Monetary and Financial Code, may not exceed 30%.

5.4. Calculating overall risk in the case of arbitrage strategies

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Funds of alternative funds/Employee investment funds/Professional investment funds

Pursuant to Articles 411-72 et seq. and Articles 422-51 to 422-60 of the AMF General Regulation, the performance achieved by a fund using the commitment calculation method is based on directional risks and should not be significantly based on trade-offs between these sources of risk. Therefore, a fund that uses trade-off strategies in a non-marginal manner, notably in the interest rate and currency markets, shall not use the commitment calculation method to calculate overall risk and shall use the VaR calculation method instead.

Determining the "material" character is left to the discretion of the asset management company. However, it shall rely on several criteria such as the contribution of the trade-off strategies to the fund's performance or risk profile. It cannot, most of the time, rely exclusively on the calculation of the percentage of the assets or exposure allocated to this strategy insofar as such a criterion does not ensure that the said strategy is not an important performance driver of the fund.

For instance, the fact that a trade-off strategy accounts for only 10% of the fund's assets does not imply necessarily that the performance depends significantly on this strategy.

The commitment calculation method can be used if the proportion of non-standard financial instruments is negligible.

5.5. Offsetting exposure to index futures with a basket of equities as part of the commitment calculation method

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Funds of alternative funds/Employee investment funds/Professional investment funds

Articles 411-75, 422-54 and 422-176 of the AMF General Regulation allows offsetting exposure to index futures with a basket of assets replicating this index. Offsetting is possible as soon as a basket of assets replicates the underlying index to the futures positions. Accordingly, it is impossible to offset exposure to an index derivative with only one asset.

Let's take the example of a fund which almost exclusively invests in French equities, safe for one German stock with a put option on the DAX index. It is impossible to offset the short position on the DAX with the German stock on the grounds that the reference markets are the same because the stock does not replicate the DAX.

In addition, it should be specified that offsetting depends on the quality of the replication. In that respect, where the basket of assets does not exactly replicate the index, offsetting cannot be total and should be adjusted with a replication coefficient which takes into account several criteria such as the tracking error, correlation or the weight of the stocks in the index. It is the duty of the asset management company to define the coefficient applied and ensure that the criteria adopted are consistent with the replication effectively implemented.

Where a fund invests in 20 stocks in the CAC 40 and that it also sells futures on the index, the short position can partially be offset with the basket of shares by taking into account the correlation between the performance of the basket of 20 stocks and that of the index when determining the offsetting level for instance.

5.6. Using the VaR calculation method when measuring overall risk

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Funds of alternative funds/Employee investment funds/Professional investment funds

Pursuant to Articles 411-71-1 et seq., 422-50 et seq. and 422-176 of the AMF General Regulation, a fund using the VaR calculation method to measure overall risk may lay out a reference portfolio with the same risk profile (or the same allocation) as that of the fund. The fund's VaR is then compared to the reference portfolio's VaR (relative VaR).
When the asset management company chooses not to lay out a reference portfolio, the regulatory requirements governing overall risk command that the fund's VaR be compared to a fixed threshold (absolute VaR).

It shall be reminded that:
- This choice must be justified;
- A CIS which fails to comply with the requirements of the predetermined calculation method cannot change its method ("breach");

- If the risk profile can easily change, the relative VaR cannot be used;
- The reference portfolio is based on a non-leveraged benchmark (with not leverage effect)

5.7. Distinction between the historical VaR and the ex ante VaR

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Funds of alternative funds/Employee investment funds/Professional investment funds

The *Autorité des Marchés Financiers* noticed, in the context of monitoring CISs and asset management companies, that there seems to be confusion between the notions of historical VaR and ex post VaR.
The historical VaR is one of the methods usually used by the financial industry to calculate the VaR. It is based on the assumption that the distribution of returns observed from the historical data will happen again in the future. It consists of reconstituting the return history of the static portfolio on the basis of the historical returns of the different risk factors present in the portfolio at the time of calculation and over the time period considered and then determining the percentile of the series obtained corresponding to the target confidence level.

Where there are 250 historical data and where the confidence level stands at 99%, the historical VaR is the third value in the ordered list of the portfolio's reconstituted performances.
The ex post VaR is the maximum dynamic loss suffered by the real portfolio over a set time frame, depending on a determined confidence threshold in a given time period.
If the ex post VaR (99%, 1 day) of a fund over a twelve-month period is 3%, this means that the fund achieved a daily performance of more than [-3%] in 99% of the cases in the past year.

In a nutshell, the historical VaR measures the ex ante risk and makes it possible to estimate the probabilistic loss suffered by a portfolio on the basis of its composition at the time of calculation while the ex post VaR is a result that reflects the dynamic behaviour of the portfolio afterwards.

5.8. Backtesting VaR models

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Funds of alternative funds/Employee investment funds/Professional investment funds

Pursuant to II of Article 15 of instruction 2011-15, the VaR models used need to be backtested in order to ensure that the net asset value of the CIS is consistent with the risk measurement procedures used. The following paragraph aims to illustrate how backtesting can be conducted. It does not seek to impose a particular method for backtesting. The backtesting method has to be defined by the asset management company and it must suit the strategies implemented and the management methods adopted.

Let's take the example of a CIS which calculates its VaR (99%, 20 days) at each net asset value determination date.
As part of the backtesting process, the asset management company can, for instance, compare the fund's weekly performance with the estimated probabilistic loss measured by the VaR and, then, count the number of times when the performance has been lower than the VaR over the time period considered. The overshooting percentage (also called exceptions) can then be compared to the 20% threshold (of which it is assumedly very close), which is the risk threshold corresponding to the confidence threshold for calculating the VaR (99%)

Conversely, comparing the fund's ex post VaR to the risk threshold may not be considered, in most cases, the only sufficient backtesting method to validate a model, although it allows a preliminary consistency check.

6. Information to investors

6.1. Determining the investment objective on the basis of market assumptions made by the asset management company

Scope: CISs

The asset management company shall ensure that the fund's investment objective is consistent with the investment strategy it looks to implement to reach the said objective, in particular when it plans setting a quantified performance objective. Indeed, although the latter is not a commitment to results, it shall nevertheless be defined on the basis of assumptions likely to occur.
Asset management companies which carry out simulations of past performances to justify setting a performance objective in the key investor investment document (KIID) and in the prospectus of a fund shall be able to take into consideration the limits of the simulation carried out and the particular circumstances (notably specific market conditions) of the time period over which these simulations are carried out. It is necessary that the quantified performance objective be consistent with the nature of the risks entailed by the investment strategy.

In the case of equity markets yielding an annual return on investment of 7% over a five-year time period, an equity fund, managed on the basis of a backtested quantitative model over a three-year time period of strong rally in the equity markets, cannot set an annual performance objective of 10% on this basis alone.

6.2. Consistency of certain types of fund transformations or of certain movements in the fund's liabilities with the information provided to investors

Scope: CISs

In the case of some specific fund transformations (for instance, the transformation of a CIS into feeder funds or the opposite, mergers), the asset management company shall ensure that the practical arrangements for the transformation are not likely to undermine the exposure to which investors are entitled under the prospectus predating and postdating the transformation.

Let's take the example of an index fund replicating the CAC 40 index which becomes the feeder fund of a master fund, yet using the same management strategy. It seems natural that investors in the fund be not temporarily desensitised to the price movements in the CAC 40 index during the transformation. They shall continue to benefit from an index-based management strategy without being impacted by the transformation procedures (deadline for subscribing for units in the master fund, subscription net asset value, valuation procedures).
Similarly, where these transformations result in important subscription/redemptions orders, the asset management company shall ensure:
- On the one hand, that these movements in the fund's liabilities do not result in important changes in the fund's risk profile which may affect investors who retain their units during the interim period;
- On the other hand, that these movements in the fund's liabilities do not result in too high friction costs associated with changes in the assets under management.

Accordingly, an asset management company which is aware that some of its investors intend to transform their direct exposure to the fund to an exposure to this fund through a feeder fund shall take steps to ensure that the fund's exposure to equities does not vary disproportionately during the successive divestment and reinvestment stages and that other investors in the fund are not impacted by the transaction or commission fees associated with these sharp movements in the structure of the fund's liabilities.

6.3. Mergers and information to investors

Scope: CISs

Overall, mergers are carried out by exchanging units in the receiving fund for units in the absorbed fund.

Although this action is not considered a subscription, and consequently not strictly governed by the receiving fund's investment conditions, the merger shall not aim at circumventing the receiving fund's investment conditions. Thus, it is the duty of the asset management company to ensure, prior to the launch of the merger, that the conditions for purchasing units or shares in the receiving fund are equivalent to the conditions for purchasing units or shares in the absorbed fund which prevailed when it was marketed.

For instance, if the subscription amount of the receiving fund is lower than €100,000 while the subscription amount of the absorbed fund is €1,000, the planned merger would allow investors in the absorbed fund to invest in the receiving fund although the investment conditions of the two funds are different. Conversely, if the subscription amount of the absorbed fund is €1,000 and the receiving is transformed prior to the merger in order to align the investment conditions of the receiving fund with those governing the absorbed fund, the investment conditions of the two funds are then equivalent and the merger may be completed.

Besides, in the specific case of mergers involving a receiving fund offering several categories of units, if the units held by investors in the absorbed fund are transferred to a single category of units for practical reasons, the draft letter to be sent to the investors shall:
- highlight the existence of other categories of units;
- offer investors who meet the investment conditions the possibility to transfer their assets to the category of their choice in order to benefit from more favourable tariff conditions.

6.4. Informing investors about the guaranteed principal amount

Scope: UCITS/Retail investment funds/Private equity funds/Real estate funds/Real estate investment trusts/Funds of alternative funds/Professional investment funds/Professional real estate funds/Declared funds/Employee investment funds/Film investment funds

Where a CIS or investors in a CIS are being offered a redemption guarantee for some or all of the invested capital, investors shall be informed precisely about the amount of the guarantee in the regulatory documents.

For instance, if the guarantee does not cover the subscription fees, this should be mentioned in the regulatory documents. Similarly, if the guarantee is before tax, this information shall be clearly mentioned in order to provide investors with accurate information.

6.5. Consistency of the information provided in the key investor information document (KIID) and in the prospectus with the information disseminated in the marketing materials of the CIS

Scope: CISs

The information disclosed in the key investor information document and in the prospectus when the fund files for approval shall always be consistent with the information disclosed in the marketing materials. Asset management companies are required to pay particular attention to this issue.

The marketing materials of a fund which promotes an investment strategy based on the selection of small caps from emerging countries cannot possibly suggest that this investment outperforms a European blue-chip index. This remark may also apply to the regulatory documents released by the funds which do not articulate a key investor information document and prospectus or by other CISs.

6.6. Marketing CISs reserved for 20 investors

Scope: AIFs

Reserved AIFs shall not be listed, advertised, sold or be subject to any other type of solicitation to the general public. This category of investors is intended to host the AIF incorporated on demand of a limited number of investors (a maximum of 20 persons). The funds concerned shall not be actively marketed, even though it is aimed at a limited number of investors.
Besides, the fact that these funds are reserved for specific investors implies that the regulatory documents they release are not available to the general public. For purposes of consistency, they cannot be communicated to funds open to all investors since this would be like distributing to the general public funds which are meant to be held by a limited number of investors.

6.7. Transformation of a fund established with a pre-determined time horizon (excluding structured funds)

Scope: CISs, excluding formula CISs

Dissolution

Several funds have filed for early dissolution with the AMF.

These files are particular insofar as dissolution would occur before the planned maturity date, thereby allowing investors to have their units or shares redeemed before the end of the investment period on the basis of which they subscribed and on the basis of which the fund should have been managed initially. Moreover, where investors have their capital guaranteed at maturity, early dissolution would prevent them from benefiting from this guarantee within the anticipated timeframe.

These files require that the right balance between investor protection and the requirements imposed on the asset management companies be found. Indeed, these requirements can prove to be so stringent that early dissolution becomes preferable, in the interests of the investors, to continuing to manage the fund. This may be the case where a fund using an insurance portfolio strategy is forced to invest in monetary assets because of a sharp decline in the markets.

The AMF shall then review the conditions under which the asset management company takes into account the interest of the investors and the potential loss they could suffer, the loss of opportunity, the subscription fees and the other costs associated with the dissolution.

Transformation

Some asset management companies have developed and marketed CISs according to a pre-determined maturity date and wish to transform these products into similar products at maturity.

It is desirable that these transformations give rise to a positive action by the investor so that its subscription in the fund is not tacitly extended. However, failing this, it is possible to change a CIS built for, and marketed over, a pre-determined time period which has expired into a product using the same investment strategy and having the same time horizon, provided that the following conditions are met:

- The new fund shall leave enough time to investors to make their investment decision (i.e. holding their units) depending on the frequency of the net asset value calculation and have their exposure to dynamic assets renewed at the end of this period only. During this period, investors shall have the possibility to redeem units free of charges.

Example:
- A two-week time period for a fund with weekly liquidity is not enough.
- A one-month period for a fund with daily liquidity is a possible option.

- The information provided to investors, by mail and before the fund expires, shall contain several pieces of information. It shall specify that the new investment product has been conceived in continuity with the preceding investment and the management procedures shall be stipulated. A new investment objective shall be proposed by the asset management company. Two assumptions shall be proposed in the letter:

- Should the investor wish to recover the capital initially invested, or should he decide to shift to a new investment profile, it must be offered the possibility to have its shares redeemed.
- Conversely, should the investor wish to invest in a similar product and subscribe for units in a fund with a pre-determined investment period, the asset management company shall inform the said investor that it retains its units and that it holds units in the new fund.