

CHAPTER 4

Investment Services Providers, Investment Products and Market Infrastructures

1 – The AMF's Action in 2008

4 – Developments in Market Infrastructures

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

In performing its duties, the AMF must protect investors and still enable the financial services industry to develop in an increasingly international and competitive market.

After a year of discussion and deliberation in 2007, the AMF implemented its Better Regulation approach in 2008. A series of reforms to CIS authorisation procedures came into force in the early part of the year. These changes, which were developed over 2007 in partnership with the industry, are intended to promote greater accountability among market participants while making the AMF's supervision more effective. Putting them into practice has improved the efficiency of the authorisation procedures.

As a result of these rationalisation measures, operational teams are now able to spend less time analysing authorisation applications and can concentrate on monitoring CIS. Monitoring has two aspects: disseminating AMF positions; and examining product-related anomalies and supervising the marketing of CIS, directly placed securities and structured products.

Efforts continued in 2008 to adapt the rules arising from MiFID transposition. This task was carried out essentially at the level of market participants, i.e. asset management companies, ISPs and FIAs.

The financial crisis had a major impact on 2008 performances, hitting asset management particularly hard. In this regard, one of the regulator's key concerns was to ensure that investors were properly informed and fairly treated and that their interests were protected.

Against this backdrop, the French fund management industry recorded the following performances in 2008:

- > gross assets under management stood at €1,246.4 billion at 31 December 2008, compared with €1,415 billion at 31 December 2007;
- > the number of collective investment schemes rose from 12,063 at end-December 2007 to 12,293 at end-December 2008;
- > the number of new collective investment schemes fell slightly from 1,360 in 2007 to 1,279 in 2008;
- > the number of investment management companies rose from 568 to 571 at 31 December 2008.
- > The number of new companies remained stable, with fifty firms opening for business in 2008 compared with 52 in 2007.

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Review of collective investing in 2008

DECISIONS		2004	2005	2006	2007	2008
Management companies/Funds	Management company authorisations	68	37	42	52	50
	Use of EU passport in other EEA states					
	Freedom of establishment	1	4	6	5	3
	Free provision of services	47	23	70	47	93
	Use of EU passport in France					
	Freedom of establishment	0	0	1	1	1
	Free provision of services	15	11	10	8	5
	Funds created *	1117	1165	1458	1 360	1 404
	Funds approved, o/w	937	1074	1247	1 124	1 082
	SICAVs	13	19	27	63	28
	General FCPs	689	797	933	768	757
	Venture capital funds	51	41	46	58	96
	Employee profit sharing funds	174	214	240	231	191
	Futures funds	10	3	1	4	10
	Real estate collective investment schemes approved, o/w	NA	NA	NA	12	50
	organised as companies (SPPICAVs)	NA	NA	NA	12	50
	organised as funds (FPIs)	NA	NA	NA	0	0
	Contractual funds declared	0	26	129	119	126
	Streamlined venture capital funds declared	31	65	82	117	196
	Approvals for fund conversions	6 745	7700	6701	4281	2663
Authorisations for European funds**	254	341	777	885	838	
Approvals of debt securitisation funds/subfunds	6	6	4	6	10	
Approvals of real estate investment trusts, o/w:	31	37	23	31	19	
Other investment vehicles	Opened to the public	8	6	9	11	6
	Capital increases	10	11	11	10	11
	Re-pricing, prospectus updates	13	20	3	10	2
	Approvals of movie investment funds, o/w	18	29	13	14	12
	Creations	11	12	10	11	10
	Capital increases	7	17***	3	3	2
	Approvals of fisheries funds, o/w:	8	2	0	1	0
	Creations	8	2	0	0	-
	Capital increases	0	0	0	1	-

Source: AMF

* creations include fund authorisations and declarations

** or sub-funds

*** incl. 14 additional approvals

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1 – The AMF’s action in 2008

A – Impact of the financial crisis on asset management

The crisis that began in summer 2007 intensified in 2008, putting the asset management industry under severe stress. Mid caps performed poorly on the markets at the start of the year. In September the collapse of Lehman Brothers, an investment bank, and mounting difficulties at hedge funds had a huge impact on alternative investing in various countries, including France.

As a prime broker, Lehman Brothers was expressly appointed by a number of depositories as sub-custodian for some or all of the assets of several French funds of hedge funds (FoHFs). Under French regulations, depositories are required to return the financial instruments held on their books, even if custody of the assets in question has been delegated to a third party. Because some management companies and their depositories were unable to come to a swift agreement on this issue, the AMF Board issued injunctions against two French depositories in November and December 2008. The depositories lodged appeals with the Court of Appeals, challenging both the principle of their liability and the list of assets to be returned. Four funds and total assets of €50 million were involved. In rulings issued on 8 April 2009, the court rejected the depositories’ arguments, upholding the AMF’s injunctions and reaffirming that the depositories were responsible for returning the assets. Furthermore, the abrupt loss of liquidity on certain markets prompted many of the hedge funds held in FoHF portfolios to place restrictions on redemptions. They did this by:

- > activating redemption gates;
- > creating side pockets to segregate a portion of their assets; or
- > delaying publication of net asset values (NAVs).

This impacted the liquidity of FoHFs, because while the funds still had to honour redemption requests from investors, they could no longer quickly disinvest from the hedge funds in which they themselves had invested.

In this turbulent setting, and given the difficulties affecting some hedge funds and asset management companies, the AMF authorised asset managers to take exceptional measures, such as introducing redemption gates or changing the frequency of NAV publication, in order to manage fund liquidity and provide investors with the best possible protection.

In all the cases that it dealt with, the AMF made sure that investors were properly informed and that their rights were protected:

- > investor information: the AMF’s first concern was to make sure that management companies whose funds had run into trouble provided their investors with appropriate information about the steps that the funds taken based on their reading of the situation, e.g. temporary suspensions, redemption gates, side pockets, liquidation;
- > equal treatment for investors: the AMF also ensured that management companies acted solely in the interest of investors and treated all their investors fairly. The AMF reserves the right to check after the fact that companies comply with these principles.

In sum, the crisis highlighted the issue of participant liability, revealing the need for a more effective framework.

B – Regulatory mechanism for short-selling

In response to exceptional market conditions, on 19 September 2008 the AMF Board established a temporary mechanism to regulate short-selling of French financial stocks¹

Initially introduced for three months, the framework included the requirement to own securities prior to selling them, and the obligation to disclose net short positions representing an economic interest of 0.25% or more of the capital of the companies concerned.

¹ AMF news releases dated 19 and 22 September 2008, available on the AMF website (www.amf-france.org) under News releases

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A working group chaired by AMF Board members Marie-Ange Debon and Jean-Pierre Hellebuyck was tasked with preparing proposals to finalise a permanent framework for all listed securities. The working group, which comprised representatives from issuers, investors, financial intermediaries, public authorities and the market operator, held hearings with numerous stakeholders.

On 18 December, the AMF Board decided to maintain the temporary mechanism pending the release of proposals by the working group and the results of coordination work at CESR and IOSCO. The working group's report, which was published on 23 February 2009², was put out to public consultation along with additional proposals by the Board until 10 April 2009.

C – Impact of the Madoff affair on asset management

News of an enormous fraud in the United States broke in mid-December. Masterminded by Bernard Madoff, the fraud also had a major impact in Europe. AMF staff acted as soon as the scheme was uncovered, contacting management companies to assess the impact on investors. The AMF was soon able to announce that French funds were exposed to "Madoff risk" to the tune of approximately €500 million³. Just 100 or so funds were affected, most of which had invested in European funds that were directly or indirectly managed through Mr Madoff's operations.

The AMF also estimated that retail investors were largely unaffected, since funds sold to qualified investors held 92% of the exposure, and retail funds just 8%. It asked all management companies with affected funds to promptly contact their customers individually and to post information online. It made sure that these instructions were acted on.

Under the exceptional circumstances, the AMF published guidance to help management companies implement appropriate measures to assess the fraud's impact and correctly value their assets, e.g. suspending subscriptions and redemptions, creating side-pockets, writing down affected investments. The AMF reminded management companies that their actions should be guided solely by the interests of their investors and by the need to ensure fair treatment for all unitholders.

D – Due consideration of the diversity of situations and more efficient processing of applications

Working group on small ISPs

The group's goal was to reduce the AMF's regulatory requirements regarding the organisation of small ISPs. The working group released its conclusions at the end of the year. A number of streamlining measures were introduced to avoid subjecting small ISPs to obligations that are disproportionate to their business and to facilitate dealings with the regulator.

The working group's recommendations, which were presented to industry associations, focused on the content of programmes of operations, compliance, internal control and risk management.

E – Ongoing implementation of the Better Regulation approach

1 > Simplifying fund authorisation procedures...

Eligible CIS were able to use the simplified and quicker (eight business days) authorisation procedure⁴ from January onwards. The new procedure is available to all funds issued by a management company if the fund is similar to a fund authorised by the AMF in the past 18 months. It is now being used to quickly, easily and efficiently process almost one-quarter of all initial authorisation requests by general-purpose CIS and employee savings schemes.

² Available on the AMF website (www.amf-france.org) under Publications > Working group reports.

³ Investors resident in France may also be affected through foreign funds, either directly (freedom to provide services) or indirectly (French or foreign unit-linked insurance policies).

⁴ Authorisation for clone schemes

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Beginning in February, steps were also taken to overhaul internal procedures for processing authorisation requests from funds not covered by the new regime. As part of this, AMF checks were refocused, while management companies were given greater responsibilities. The AMF has committed itself to issuing prospectus drafting guidelines in order to help management companies prepare applications and to facilitate the authorisation process.

Fund conversion procedures were also reformed, drastically reducing the number of fund conversions requiring authorisation and easing the administrative burden on management companies: from between 4,000 and 8,000 applications a year, the number of conversions requiring authorisation fell to 2,663 in 2008.

As part of the procedural changes, the AMF authorised electronic filing of applications, thereby helping to cut the costs of authorisation procedures. Management companies gave a warm welcome to the new filing procedure, which is now used for around 90% of new fund applications.

2 > ...to ensure that products are monitored more effectively, for enhanced investor protection

The AMF wants to use its Better Regulation approach to refocus its activities so that it can concentrate more closely on monitoring marketing operations. As part of this, in 2008 the regulator worked to make its positions more transparent by introducing a new dissemination process, which included the publication of three new documents:

- > Guide to preparing CIS prospectuses;
- > Guide to best practice in drafting marketing literature;
- > Monitoring CIS practices: summary of observations.

The three documents are prepared in conjunction with practitioners and will be updated twice a year.

Furthermore, under the Labour, Employment and Purchasing Power Act, individuals liable for wealth tax are eligible for tax relief if they invest in certain financial products. In this context, the AMF issued a reminder regarding the requirements for marketing the products in question.

a) Educational activities

Guide to preparing CIS prospectuses⁵

This guide is intended to help management companies prepare fund prospectuses and circulars in accordance with the regulations. The document:

- > reviews some of the applicable rules along with implementation procedures;
- > gives recommendations on applying the rules;
- > describes good and bad practices to illustrate how to implement the rules and recommendations.

Guide to best practices in drafting marketing literature⁶

To facilitate the enforcement of regulations, the AMF has begun identifying best practices for the drafting of marketing literature for financial products.

It now regularly publishes its analyses of marketing documents to keep the industry informed of practices that are felt to be inconsistent with the current regulations as well as those that are deemed likely to enhance information quality.

b) Monitoring of CIS practices: summary of observations⁷

Consistent with the Better Regulation approach, and in parallel with the introduction of new fund authorisation procedures, the AMF has stepped up monitoring of existing funds. The aim is to ensure that the way that funds are operated and the management strategies followed are consistent with fund prospectuses as well as with legal

⁵ Available on the AMF website at http://www.amf-france.org/documents/general/8205_1.pdf

⁶ Available on the AMF website at http://www.amf-france.org/documents/general/8304_1.pdf

⁷ Available on the AMF website at http://www.amf-france.org/documents/general/8712_1.pdf

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and regulatory provisions. These activities are separate from the inspections and investigations that the AMF may also carry out.

The summary of observations from these activities is being published to inform asset management companies, depositories and auditors about the AMF's main comments in relation to its monitoring of CIS. They can then take these comments into account when preparing and implementing their own control systems. The document therefore:

- > reviews applicable regulations;
- > gives recommendations on applying them;
- > provides example cases of compliance and non-compliance with the regulations.

The positions set out in the document follow on from those that the AMF has already published or applied when reviewing individual applications for authorisation to create or convert funds.

Marketing of investment vehicles under the tax framework of the Labour, Employment and Purchasing Power Act

The AMF issued a reminder of the solicitation and marketing rules to parties marketing these products, which include unlisted securities, investments in holding companies, venture capital funds (FCPR), innovation funds (FCPI) and local investment funds (FIP).

On 15 April 2008 the AMF published a position on the marketing of investment vehicles offering tax relief to individuals liable for wealth tax⁸. It conducted a special programme to monitor the marketing of the first 29 authorised FCPI and FIP funds claiming eligibility for wealth tax relief. Two problems were detected:

- > failure to comply with the principle of equal information regarding the tax advantages and risks associated with the product;
- > marketing based on legal and commercial documents that were not provided to the AMF when the products were initially authorised.

F – Supervision of participants

1 > Revocation of authorisations

In 2008 the AMF twice used its powers under Article L. 532-10 of the Monetary and Financial Code to entirely or partly revoke the authorisation of an asset management company. The revocations took place in the following circumstances:

- > following an inspection by the Secretary General of the AMF, it was discovered that Prime Capital, an asset management company, no longer had the resources required to carry on its business. On 4 March 2008 the AMF revoked the company's authorisation to operate as an asset management company, with effect from 11 April 2008;
- > in view of the difficulties that the AMF had encountered in discharging its duties, and in order to preserve the interests of investors, the Chairman used the powers conferred to him under Article L. 621-14 of the Monetary and Financial Code and asked the presiding judge of the Paris district court to issue an injunction against Edelweiss Gestion, an asset management company. Following this request, the presiding judge of the Paris district court issued a ruling on 21 February 2008 in which he:
 - > instructed Edelweiss Gestion to restrict its activities to the measures necessary to preserve its clients' interests;
 - > appointed a management controller to detail and supervise the management practices employed by the company.

Since Edelweiss Gestion no longer satisfied the conditions for the ongoing approval of its special programme of operations for the management of contractual CIS, the AMF withdrew its approval on 1 April 2008, initially effective 16 May 2008. The date was pushed back to 13 June 2008 to give time to implement the partial revocation of authorisation under the supervision of an AMF-appointed representative.

⁸ Available on the AMF website (www.amf-france.org) under Texts > AMF Positions

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2 > Issuance of professional licences for investment services compliance officers (RCSIs) and compliance and internal control officers (RCCIs)

The AMF issues professional licences to:

- > the RCSIs of ISPs;
- > the RCCIs of asset management companies.

a) Issuance of RCSI licences

There was a sharp increase in the number of applicants taking the license examination for RCSIs in 2008. This was primarily attributable to a major push to renew compliance departments, reflecting retirements and the expansion of the compliance function.

Issuance of RCSI licences

RCSI	2007		2008	
	17th session	18th session	19th session	20th session
Persons trained*	41	68	79	60
Candidates sitting the exam**	34	38	48	40
Licences awarded	31	32	39	34
Rejections	3	6	9	6
Pass rate (%)	91%	84%	81%	85%
% of candidates relative to number of persons trained	83%	56%	61%	67%

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

**Not all persons sitting the exam had previously signed up for training

The main reasons for rejections are:

- > insufficient job tenure, making it difficult to have a comprehensive view of the function;
- > shortcoming in the organisation of the compliance function (insufficient resources, problems with the compliance officer's reporting lines, problems with the organisation of the compliance function, risks of dilution of the authority conferred by the professional license because of the number of licenses issued for the same firm, etc.).

In most cases, the persons who failed the examination took it again at the next session and obtained their professional license, after remedying the problems identified by the jury.

In some cases, the jury issued licenses with remarks or requirements.

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b) Issuance of RCCI licences

In 2008 the AMF noted a substantial increase in the number of applicants taking the RCCI license examination, after many asset management firms renewed staffing in this function in 2007.

Issuance of RCCI licences

RCCI	2007		2008	
	1st session	2nd session	3rd session	4th session
Persons trained*	32	45	45	50
Candidates sitting the exam**	19	24	22	42
Licences awarded	16	19	18	36
Rejections	3	5	4	6
Pass rate (%)	84%	79%	82%	86%
% of candidates relative to number of persons trained	59%	53%	49%	84%

The reasons given for refusing to issue licenses were similar to those given for refusing to issue professional licenses for RCSIs. More specifically, there were several cases involving small management companies where it turned out that the applicant did not have the requisite authority to perform the functions. In these cases, the juries deemed that it would be better to issue licenses to managers, who would then be allowed to rely on the applicants to actually carry out the supervision.

c) Requests for a jury opinion when the RCCI function is outsourced

When small asset management firms use the services of outside companies, the provider selected by the management firm must present itself to the examination jury. Since 2008 the manager holding the RCCI licence is required to appear before the jury alongside the RCCI provider. This ensures that the manager is more closely involved in the provider's performance of its duties.

In 2008 there was a large increase in the number of companies appearing before the examination jury, chiefly because of the rise in the number of new small asset management companies, which often outsource RCCI functions.

No. of outsourcing cases submitted to the jury

	2007		2008
	Session 1	Session 2	Session 3
No. of outsourcing cases submitted to the jury	13	25	15
Accepted	5	25	13
Rejected	8	0	2

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G – Adapting the regulatory framework

1 > Ongoing MiFID implementation

a) AMF Instruction 2008-03 of 8 February 2008 on authorisation procedures and programmes of operations of asset management companies and ISPs carrying on the business of asset management or investment advice.

MiFID's entry into force in November 2007 entailed changes to AMF rules and regulations. Following approval of the new Book III of the General Regulations, which transposed MiFID, Instruction 2006-02 of 24 January 2006 on asset management authorisation procedures and programmes of operations was repealed following a consultation and replaced by Instruction 2008-03 of 8 February 2008 on authorisation procedures and programmes of operations of asset management companies and ISPs carrying on the business of asset management or investment advice.

As part of the updating process, the old provisions contained in Instruction 2006-02 were brought into compliance with the recast General Regulation. Among other things, Instruction 2008-03 overhauled the standard application package for asset management companies (see Annex), introducing modifications to incorporate legal and regulatory changes and enable the AMF to concentrate its supervisory activities on the information needed to understand the organisation and resources used by firms to carry on their proposed business and control the associated risk.

b) Adjusting the framework for financial investment advisers⁹

As part of the ongoing process of MiFID transposition, the framework for financial investment advisers (FIAs) was modified to ensure consistency with the new obligations placed on ISPs providing the service of investment advice. As a result, FIAs are now subject to the fee disclosure requirements that already applied to all ISPs. Changes were also made to the conditions under which FIAs are allowed to receive and transmit orders to purchase or subscribe for CIS shares/units made by customers after receiving advice (the amendments apply solely to these types of orders).

c) Applying rules of business conduct to the marketing of CIS and real estate CIS by asset management companies

In relation to MiFID transposition, to deliver regulatory consistency and ensure that all investors receive the same protection, asset management companies are now subject, under Article 411-53 of the General Regulation¹⁰, to the rules of business conduct applicable to ISPs as regards the marketing of CIS and real estate CIS.

AMF Instruction 2008-04 of 15 July 2008¹¹ details the requirements for implementing the rules of conduct. These requirements reflect the particular characteristics that apply to the marketing of CIS or real estate CIS shares and units. For example, certain customer disclosure requirements may be satisfied by providing a copy of the simplified prospectus or the fund circular. Also, the share/unit subscription order may act as the contract required under the General Regulation when order execution or reception/transmission services are provided to retail customers. The instruction also stipulates how to apply the best execution obligation to investments in CIS or real estate CIS shares/units.

2 > CIS regulation and liquidity

New measures have been introduced to facilitate CIS liquidity management and provide a reference framework for the industry.

French legislation was modified to allow greater flexibility in terms of the frequency of NAV calculation. The revised requirements are in line with current European standards.

⁹ General Regulation approved by an order dated 26 December 2007 and published in the Official Journal of 17 January 2008.

¹⁰ Approved by an order dated 18 March 2008

¹¹ Regarding the application of conduct of business rules to the marketing by asset management companies of shares or units in CIS or real estate CIS

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The Executive Order of 23 October 2008 then established the operating principles for two new mechanisms made available to CIS. Now, funds with streamlined investment rules can place limits ("gates") on redemptions; and all funds are allowed to set up side pockets, i.e. separate funds for assets that are the subject of a specific event rendering their sale inconsistent with the interests of shareholders or unitholders.

Towards the end of the year, an instruction was issued concerning the organisation of asset management companies and ISPs as regards the valuation of financial instruments. This provided the industry with a standard framework for introducing an organisation and resources for the valuation of financial instruments.

a) Frequency of NAV calculation

Unlike equivalent European products, French general purpose CIS were required, until 2008, to publish NAVs twice a month, or even daily in the case of funds with large amounts of assets under management. Furthermore, a CIS that had opted to publish its NAV on a daily basis could not subsequently alter that choice. These restrictions were eased in late September 2008. The AMF is allowed to authorise monthly publication of fund NAVs. And, still subject to the AMF's authorisation, the publication frequency can be reduced or increased during the fund's lifetime with any special requirements other than the obligation to provide investors with appropriate information or, as the case might be, give them the opportunity to exit the fund free of charge. This increased flexibility, which is more in line with European standards, should enable management companies to tailor fund operating rules more effectively to certain management strategies, investor requirements and marketing approaches.

b) Redemption gates

CIS with streamlined investment rules are allowed to create gates, that is, restrict redemptions over a particular threshold at a given NAV date, with remaining redemptions being carried forward to the next period. The gating mechanism must be described in the fund prospectus, and the method used should be consistent with the fund's asset and liability structure. The asset management company is responsible for deciding whether to activate the gate once the necessary conditions are in place. The option of not activating the gate should also be included in the prospectus.

The AMF authorised CIS to create gates to help them cope with the exceptional loss of liquidity on certain markets. Specifically, they were able to deal with problems created by the fact that foreign hedge funds in which French CIS were invested were themselves forced to restrict their own liquidity by introducing side pockets and or redemption gates.

Note that this mechanism was introduced in a unique market context that prompted the AMF to authorise asset management companies to take exceptional measures to modify the liquidity arrangements of FoHFs, if they felt that such measures were necessary to preserve the interests of their investors¹².

In all, 101 CIS modified their liquidity arrangements. These funds accounted for 53% of the assets of French FoHFs authorised by the AMF.

c) Side pockets

Unlike redemption gates, side pockets can be created by any fund. Whereas changes to the frequency of NAV publication and gates were designed specifically for the purpose of managing fund liquidity, the side pocket mechanism was created to help deal with exceptional events affecting certain fund assets. Accordingly, the decision to create a side pocket fund should remain an exceptional course of action and only certain specified assets should be held in such funds.

When a side pocket is created, the original fund is demerged. A clone fund is set up, while assets that are hard to price are transferred to a specially created new contractual fund that is managed in run-off mode. These steps may be carried out without AMF authorisation, but the AMF should nevertheless be informed promptly about them. Having a validated programme of operations for contractual funds is not a pre-requisite for a contractual fund to be created at the end of this process.

¹² http://www.amf-france.org/documents/statique/fr/formulaires_ppe/fichiers_ppe_2008/liquidite_notegenerale.pdf

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The AMF discussed this issue in its December 2008 Monthly Review, publishing a set of frequently asked questions concerning fund demergers carried out pursuant to the second paragraph of Article L. 214-19 or the second paragraph of Article L. 214-30 of the Monetary and Financial Code¹³.

The mechanism has been operational since 21 December 2008. Although no side pockets had been created by the end of 2008, the arrangements were nonetheless used to cope with the effects of the Madoff fraud from early 2009 onwards, with the worst affected funds creating side pockets for assets associated with failed Madoff funds.

d) Instruction 2008-06 of 9 December 2008 concerning the organisation of asset management companies and ISPs as regards the valuation of financial instruments¹⁴

In response to the subprime crisis, and as part of the drive to disseminate its positions on the valuation of financial instruments, on 30 December 2008 the AMF published an instruction that:

- > restated the position issued by the COB, the AMF's predecessor, in 2003 concerning the valuation of OTC derivatives¹⁵, extending it to all financial instruments requiring the use of a model;
- > stressed the need to establish and abide by valuation procedures, particularly as regards the requirements for using valuation models.

Instruction 2008-06 was drawn up with input from professional associations and provides the asset management industry with a standard framework for establishing an organisation and resources for valuing financial instruments.

3 > Updating Instruction 2005-05 on employee savings funds

The amendments introduced by Act 2006-1770 of 30 December 2006 to promote employee share ownership were incorporated into Instruction 2005-05 of 25 January 2005 on employee savings funds. Chiefly, the changes entail:

- > introducing a streamlined regime for employee savings funds investing in the company's unlisted securities and backed by a liquidity mechanism whereby the company itself, a company controlling it, or a company controlled by it, agrees to buy back the securities;
- > creating a new type of employee profit-sharing fund specially designed for employee buyouts. This kind of scheme invests in the unlisted securities of the company and is covered by a new settlement model in the instruction;
- > establishing procedures for valuing debt securities included in the assets of employee profit-sharing funds investing in the company's unlisted securities.

The changes made follow on from positions laid out in the Q&A referred to in the 2007 Annual Report¹⁶.

The instruction also included amendments to update references to the Labour Code and incorporate the new five-year limit on actions in personam or against property created by Act 2008-561 of 17 June 2008.

¹³ Available on the AMF website (www.amf-france.org) under Texts > AMF Positions

¹⁴ Available on the AMF website (www.amf-france.org) under Texts > AMF Instructions

¹⁵ COB Monthly Bulletin No. 381, July-August 2003, available on the AMF website (www.amf-france.org) under Texts > COB Positions

¹⁶ Available on the AMF website (www.amf-france.org) under Texts > AMF Positions

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H – Dissemination of AMF positions

1 > Statement of decisions concerning CIS and investment fund performance swaps and structuring of actively managed products

CIS performance swaps are forward financial instruments that allow one CIS (the "lead" fund) to receive the returns of one or more "underlying" funds. For some years, asset managers have employed this type of swap within structured funds as a means to tap into the expertise of specialised managers. Given the potential issues raised by such arrangements, notably in terms of investor disclosures, conflicts of interest and valuation, the AMF clarified its position in this area.

To harmonise the rules applicable to CIS and structured debt securities, such as EMTN¹⁷ and other certificates, the AMF also took the opportunity to analyse projects proposed by asset managers to structure actively managed products. The aim was to assess the conditions under which fund structures linked to baskets of assets (e.g. equities or other funds) whose make-up is actively managed or regularly modified on a more or less discretionary basis, might be eligible for inclusion in CIS.

Following this study and after consulting with industry groups, on 28 February 2008 the AMF published a statement of decisions¹⁸ detailing a number of points and setting out recommendations to be carefully heeded by funds using performance swaps or structuring actively managed products.

2 > Introduction of financial management outsourcing arrangements for funds or individual portfolios

Because it was being asked to give its opinion on or approve an increasing number of proposals to outsource financial management responsibilities, the AMF decided¹⁹ to reiterate the relevant regulatory provisions and to specify how they should be implemented in the most common instances. If financial management is outsourced, in accordance with the MiFID and UCITS Directives²⁰, the responsibility of the management company delegating these tasks remains unchanged²¹ and the specific provisions covering outsourcing are designed to limit the related risks, protect the regulator's supervisory capabilities and prevent the emergence of "letter box" entities.

The most frequently asked questions in this area concern the balance between outsourced and non-outsourced activities and oversight of outsourced activities.

On the first point, the AMF said that the share of outsourced activities should not exceed that of non-outsourced activities, these shares being assessed using criteria appropriate to the individual situation.

On the second point, the AMF said that the management company should be able to demonstrate the extent to which its oversight system, which should be formally established and traceable, enables it to effectively oversee outsourced management and to control the additional risks relating to outsourcing.

The AMF said that the programme of operations should be updated in three situations, i.e. where the arrangements involve:

- > strategies similar to those customarily implemented by the delegating company;
- > strategies with a different risk/reward profile from the strategies implemented by the delegating company, where the entity to which operations are outsourced is part of the same group;
- > strategies with a different risk/reward profile from the strategies implemented by the delegating company, where the entity to which operations are outsourced does not belong to the same group as the outsourcing company.

In each case, the outsourcing agreement must be accompanied by changes to the oversight system and identification of the operational risks associated with this type of arrangement, taking into account the complexity of the outsourced strategies and, where appropriate, the existence of a group-level oversight system.

¹⁷ Euro Medium Term Notes

¹⁸ Available on the AMF website (www.amf-france.org) under Texts > AMF Positions

¹⁹ In an article published in Monthly Review No. 45, March 2008, and available on the AMF website (www.amf-france.org) under Texts > AMF Positions

²⁰ Articles 313-72 to 313-76 of the AMF General Regulation concerning individual management and Articles 313-77 and 313-78 concerning CIS management

²¹ Point 6 of Article 313-77 as regards CIS management and I of Article 313-75 as regards discretionary management

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A simplified procedure was introduced for updates to programmes of operations to facilitate administrative dealings with the regulator. Now, once an asset management company updates its programme of operations, the AMF merely needs to be notified if outsourcing arrangements are introduced for the funds in question.

3 > Maturity of authorised private equity funds

Having noted differences in the approaches taken to manage the maturity of retail private equity funds, specifically FCPI funds, the AMF issued a reminder²² of the current regulations and specified how they should be applied to authorised FCPR, FCPI and FIP funds.

The term of a private equity fund is stated in the fund's bylaws. By definition, the proceeds earned from assets should be returned to investors no later than the end of this period. The liquidation of all the assets held by the fund should therefore be completed by this time. Accordingly, the management company needs to manage the fund's portfolio in such a way as to meet this requirement. In particular, this means that the process of selling unlisted assets should be begun sufficiently early to be completed before the fund reaches the end of its life.

4 > Q&A about setting up contractual FCPR funds

Economic Modernisation Act 2008-776 of 4 August 2008 created a new type of fund known as a contractual venture capital funds.

The introduction of this new legal framework raised questions among professionals. To answer them, in November 2008 the AMF published a document²³, prepared with input from industry groups, that provides clear responses to the most frequently asked questions and discusses problematic situations that might be encountered when setting up these new funds. The document covers the definition, establishment procedures, scope of investment and operating procedures of contractual venture capital funds.

The Q&A was presented to professionals in conjunction with industry groups.

4 – Developments in market infrastructures

The AMF worked closely with other competent regulators and supervisors²⁴ to review the projects submitted to it in 2008 by the Euronext, LCH.Clearnet and Euroclear groups, and by ISPs operating multilateral trading facilities (MTFs).

A – Regulation and activity of Euronext, the market operator

In 2008 the regulators of NYSE Euronext discussed and approved three major projects: the proposed creation of a Universal Trading Platform, the introduction of a Single Order Book for securities listed on several venues, and the launch of a test phase for the new trading rules for warrants and certificates.

1 > Universal Trading Platform

The creation of the Universal Trading Platform (UTP) formed part of the consolidation of NYSE Euronext group information systems and the harmonisation of trading environments in Europe and the USA.

²² In an article published in Monthly Review No. 46, April 2008, and available on the AMF website (www.amf-france.org) under Texts > AMF Positions

²³ Available on the AMF website under Publications > Guides > Professional guides

²⁴ The members of the College of Euronext Regulators include Holland's AFM (Authority for the Financial Markets), the AMF, Belgium's CBFA (Commission Bancaire et Financière et des Assurances), Portugal's CMVM (Comissão do Mercado de Valores Mobiliários) and the UK FSA (Financial Services Authority).

The Clearing Coordination Committee members, who supervise LCH.Clearnet SA, include the French, Belgian, Dutch and Portuguese regulators, along with the Banque de France, the BNB (Banque nationale de Belgique), the Bank of Portugal, the Commission Bancaire, CECEI and the DNB (De Nederlandsche Bank). The competent authorities for the LCH.Clearnet group also include the FSA and the Bank of England.

The Committee of competent authorities for Euroclear includes the Belgian, British, French and Dutch regulators and central banks. The Irish regulator and central bank have observer status

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As well as drastically modifying the technical architecture (single network and connection point for all group markets), the introduction of the UTP also resulted in rule changes that created a new type of orders²⁵, modified the characteristics of existing orders and introduced a new policy for managing "reservation thresholds"²⁶. These innovations and modifications were part of the push to harmonise the functionalities provided on NYSE Euronext's European markets and US markets (where they already existed) and to respond to growing competition from MTFs in Europe.

2 > Single Order Book

Changes to the harmonised rules (Book I) introduced with the proposed Single Order Book (SOB)²⁷ chiefly served to introduce the concept of the "Market of Reference", which is used to describe the market on which trades are carried out in the SOB, as contrasted with other markets, to which a security may also be admitted, but where it may only be traded through off-order book trades.

The SOB project, which is linked to the implementation of phase 3 of Euroclear's ESES project (cf. below, point D), went live on 14 January 2009.

3 > New market model for warrants and certificates

NYSE Euronext wanted to change the market model for trading warrants and certificates to more effectively capture the special nature of this market and the key role of the liquidity provider. The new model, which regulators have authorised to begin operating in a test phase, will be different from the current algorithm in two main respects:

the framework for trades, which must be within the bid-ask spread of the liquidity provider²⁸;
remaining orders by the liquidity provider in the order book, which may be indicative²⁹.

4 > Other modifications

a) Non-liability

NYSE Euronext asked to amend Article 1.6 of Book I to clarify its role by detailing its obligations and limiting its liability with respect to members and issuers in cases where the market operator is acting under its general obligations as regards the organisation of regulated markets (i.e. the obligation to ensure fair, orderly, efficient markets), notably by taking provisions that were previously contained in the member admission agreement and incorporating them into the rulebook.

b) Specific segment

Article P1.3.1 of the local rules for Euronext Paris on the Specific Segment³⁰ was amended. The changes were intended to reflect the renumbering of Article 6903 of the harmonised rules (Book I), which gives a definition for the Specific Segment, and the cited articles of the Commercial Code, and more importantly to accommodate the new provisions introduced by the reforms to insolvency proceedings, notably the introduction of the new protection procedure (procédure de sauvegarde) for companies in financial difficulty.

²⁵ Pegged orders, which are designed to track the best limit displayed in the order book, are defined in Article 4203/4 of the harmonised rules (Book I).

²⁶ Article 4403/1A of the harmonised rules (Book I) was amended.

²⁷ Single Order Book (SOB).

²⁸ See the new Article 4203/6 of the harmonised rules (Book I).

²⁹ See Article 4401/2 of the harmonised rules (Book I), which has been supplemented

³⁰ "The objective of this specific segment is to group together securities whose market and/or financial characteristics are affected by events that might disrupt their situation in an enduring way or threaten the fair, orderly and efficient operation of the market."

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c) Admission of Exchange Traded Funds (ETF) to Euronext Paris

Local Instruction N3-03 governing the admission of ETFs to Euronext Paris was amended to do away with the additional obligations that were placed solely on the Paris market (requirement for Euronext to sign agreements with at least two market members acting as market makers, whereas Article 6705 of Book I of the harmonised market rules requires a minimum of just one liquidity provider).

As at 31 December 2008, 348 ETFs were admitted to Euronext markets, of which 269 admitted and traded in Paris, and 48 were admitted in Paris and Amsterdam and traded in Amsterdam³¹.

In 2008 there were 164 new admissions of ETFs, of which 141 were admitted and traded in Paris and 8 were admitted in Paris and Amsterdam and traded in Amsterdam.

B – Multilateral Trading Facilities

1 > Bluenext Derivatives

In March 2008 the AMF Board sent CECEI a favourable opinion on the programme of operations of Bluenext SA concerning the investment service of operating Bluenext Derivatives, a multilateral trading facility. The company subsequently received authorisation from CECEI.

Bluenext Derivatives is a futures market for the trading of two futures contracts in CO2 emission quotas, also known as greenhouse gas emission allowances (European carbon emission quotas and Kyoto credits), each with four annual expiries through to 2012, i.e. eight instruments in all. The company also operates a spot market in emission allowances, which did not require authorisation since these allowances are not considered to be financial instruments.

2 > Powernext Derivatives

In October 2008 Powernext SA, a company that has operated an electricity futures market since 2001, applied to modify its rules in order to create a new segment to trade natural gas futures contracts (Powernext Gas Futures).

The changes consisted in organising provisions shared by the gas and electricity segments and non-shared provisions in different sections of the rulebook.

The main difference concerns clearing: while LCH.Clearnet SA clears trades in electricity contracts, trades in natural gas contracts are cleared by European Commodity Clearing (ECC), a German clearing house that is a subsidiary of European Energy Exchange (EEX), a German energy market.

3 > MTS France

In June 2008 the institutional segment of the secondary market in French government debt was opened up to competition. At that time MTS France, the ISP operating the trading platform of the same name, applied to modify its market rules to incorporate the provisions called for by the Euro Debt Market Association (AMTE) to regulate all competing platforms.

The AMF Board did not oppose the rule changes proposed by MTS France, since the provisions called for by AMTE were contained in the existing MTS France rules and the changes were essentially a case of reorganisation.

³¹ Traded: Market of Reference within the framework of the Single Order Book

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C – Activity and regulation of LCH.Clearnet SA, the clearing house

LCH.Clearnet SA, a clearing house, submitted several projects to the AMF Board in 2008 aimed at broadening the scope of markets on which it offers clearing services, along with the corresponding changes to its operating rules:

> on 4 March 2008, the AMF Board approved the proposed offering of services to the Luxembourg Stock Exchange. As a result, since 14 March 2008, LCH.Clearnet SA has provided a technical service for eligible securities, linking the trading platform and the settlement system. It is also providing guarantees for the most liquid securities;

> on 19 June 2008, the AMF Board reviewed the proposed offering of services to Equiduct, a platform operated by the Berlin Stock Exchange. The Board approved the project and the corresponding changes to the clearing house's operating rules, provided that certain conditions were met, including the need to obtain the necessary agreement from the other relevant authorities. LCH.Clearnet SA will guarantee transactions involving equities traded on Equiduct and admitted to NYSE Euronext's European markets;

> on 12 September 2008, the AMF Board approved LCH.Clearnet SA's project to clear and guarantee transactions in equities admitted to trading on NYSE Euronext's European markets and traded on Smartpool, a UK platform for block trading in equities.

LCH.Clearnet SA will implement the same risk management system for the Luxembourg Stock Exchange, Equiduct and Smartpool as that used to clear NYSE Euronext's European cash markets, using the same methods to calculate initial and other margins and the same mutual guarantee fund.

In 2008 LCH.Clearnet SA also took over clearing for trades in CO2 emissions quota derivatives traded on the Bluenext Derivatives platform. The clearing house's operating rules were modified. Notably, they now stipulate that Bluenext clearing members will pay into one of the two guarantee funds already set up at LCH.Clearnet SA. Meeting on 15 April 2008 the AMF Board approved these rule changes, with the proviso that the use of the existing guarantee fund should be reviewed in the event of plans to admit industrial firms as clearing members of Bluenext.

The AMF Board also approved sundry other changes to the LCH.Clearnet SA operating rules, notably in connection with the Euroclear group's ESES project (cf. below, point D).

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

In 2008 the Euroclear group continued working on its Euroclear Settlement of Euronext-Zone Securities (ESES) project. ESES, which is being taken forward jointly by Euroclear France, Euroclear Belgium and Euroclear Nederland, aims to provide the three entities' members with an integrated settlement platform and a harmonised securities custody service. The first phase of the project got under way on 26 November 2007, when RGV2, Euroclear France's settlement system, migrated to the ESES France system. Phase two began on 18 February 2008 with ESES France's connection to TARGET2, the system for euro payments in central bank money, and the introduction of the Banque de France's new overall collateral management system. Phase three was implemented on 19 January 2009 with the migration of Euroclear Belgium and Euroclear Nederland to ESES. At its meetings of 22 January 2008 and 13 November 2008, the AMF Board approved the modifications to the operating rules of Euroclear France in its capacity as settlement system operator and central depository, in connection with phases two and three of ESES.

The Euroclear group submitted a proposal to bring Euroclear France's governance into line with the arrangements at Euroclear Belgium and Euroclear Nederland. At its meeting on 25 November 2008, the AMF Board approved the proposal, which seeks to strengthen coordination by the three entities on ESES-related issues, while preserving specific national characteristics. Under the new arrangements, a single Chief Executive is to be appointed, membership of the entities' boards will be harmonised and an ESES college will be set up to act as a shared consultative body to help the three entities prepare ESES-related decisions. To preserve specific national characteristics, each entity will appoint a country director, who will be a member of the ESES College.

NB: detailed statistics on authorisations and approvals issued to asset management companies, ISPs and CIS are contained in Annex 3, which is available on the AMF website (www.amf-france.org), under Publications > Annual Reports.