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Regulatory news and key issues, Autumn 2017

With the summer season behind us, Xavier Parain, head of asset management, reviews the latest regulatory developments and key issues for the coming period. He gives a progress update on the steps taken so far and looks at the big deadlines in the months ahead for the MiFID 2 reforms to the Markets in Financial Instruments framework, packaged retail and insurance-based investment products (PRIIPs) and other European issues, including securitisation and the Money Market Funds Regulation.

Read on to learn about the new economic opportunities being created this autumn, the latest on the Sapin 2 framework, and how proposals by the FROG group to boost competitiveness are being put into practice. We also touch on several pieces of European legislation, looking at key dates and the final stages remaining before their introduction.

With summer officially behind us, what are the latest regulatory developments?

The system enabling certain collective investments to originate loans is now fully up and running after the final outstanding provisions were published in the AMF General Regulation over the summer.

The aim of this change is to marry new economic opportunities with a secure legal framework. Management companies that manage lending funds must be authorised by the



AMF or another European authority, which makes sure that they have the specific skills required for the activity, that they abide by the organisational rules governing relations with borrowers (information, KYC and anti-money laundering) and that they set up a robust process for authorising loans.

Lending funds are also bound by rules to mitigate financial stability risks (loans held to maturity, redemption and leverage restrictions). Loans may be granted exclusively to non-financial companies (NFCs) and their term may not exceed the remaining life of the fund.

The AMF has already authorised a dozen management companies of various types to carry on this new direct lending activity. Initial loans have gone towards financing infrastructure projects and funding small and mid-sized businesses.

We have also worked with the government over the last ten months to overhaul the regime for securitisation entities through a recently published executive order as part of the Sapin 2 Act. Specifically, we have created a new type of vehicle known as a specialised financing vehicle. These new entities are subject to the Alternative Investment Fund Managers Directive (AIFMD) and will operate alongside the existing securitisation vehicles. A specialised financing vehicle will be an untranchéd alternative investment fund (AIF) that is allowed to raise financing by issuing bonds. Being subject to the AIFMD will enable specialised financing vehicles to receive cross-border marketing passports and the European long-term investment fund (ELTIF) label. These benefits are not available to conventional securitisation vehicles.

We also clarified the tasks of securitisation vehicle depositories, which were established back in 1988, to align them with the AIFMD.

To make securitisation vehicles more competitive, we revamped the procedures for transferring claims. Securitisation vehicles will now have more reliable access to the collateral supporting purchased claims and may transfer claims to foreign investors under an exemption to banking monopoly rules.

Measures introduced by Executive Order No. 2017-1432 of 4 October 2017 modernising the legal framework for asset management and debt financing

- Overhaul the regime for securitisation vehicles and create specialised financing vehicles
- Amend the exemption from banking monopoly rules to make it easier for claims not yet due to be transferred to non-French entities
- Finalise legislative work on forestry investment groups
- Make it possible to supplement liquidity risk management tools in accordance with the conditions set out in the AMF General Regulation
- Create new French employee investment funds (FCPEs) invested in the securities of foreign companies and intended for their employees
- Enable SCPI real estate investment funds to use financial contracts to hedge currency risk

A year on from its launch, what progress has the FROG made?

The AMF has kept its promises and put the proposals made by the French Routes and Opportunities Garden (FROG) group into practice, making the requisite changes to the AMF's General Regulation and policy. Each measure has already been trialled by at least one management company and could be of interest to all management companies.

With this in mind, I would like to remind management companies about two upcoming deadlines.

They have until 8 November 2017 to update their prospectuses as regards disclosure of "financial management" costs, which are internal to management companies, and "administrative expenses that are external to the management company". This new disclosure format will provide a clearer picture of the cost of French investment management and should be a real boon for fund competitiveness;

Funds have until 31 December 2017 to delete all references to the "diversified funds" classification, which was a source of confusion, from their regulatory documentation.

Seven FROG-led innovations

- Expanded management delegation options
- Registered intermediary enshrined in French law
- AMF fund classifications now optional
- Funds allowed to retain a performance track-record if they are converted from an FCP to a SICAV
- Improved clarity on fund management expenses

- Widespread introduction of redemption gating mechanisms
- Pre-marketing in France

The AMF has no plans to relax its efforts to promote the Paris marketplace: the FROG group will be meeting regularly to assess the benefits of action taken, fine-tune implementation and maybe even suggest new measures.

In addition to work carried out through the FROG, the AMF also signed a competitiveness agreement this summer with the Hong Kong regulator that will allow certain French UCITS to be marketed there via an accelerated authorisation procedure.

Two major pieces of legislation will come into effect on 3 January 2018: what to expect from MiFID 2 and PRIIPs?

MiFID 2:

The reformed Markets in Financial Instruments Directive (MiFID 2) strengthens the existing regime as regards remuneration and inducement rules. It also establishes new obligations for financial product governance, making manufacturers and distributors accountable for ensuring that investors are offered suitable products.

European lawmakers were not targeting collective investments when they drafted MiFID 2, but rather institutions providing investment services. As a result, the reforms affect discretionary portfolio management, investment advice and reception and transmission of orders (RTO) on behalf of third parties.

Which is why, in keeping with the European model, France has decided to create separate legal statuses for investment firms and asset management companies. An entity that engages in at least one UCITS or AIF management activity will have asset management company status, while any entity providing investment services other than collective investment will have the status of investment firm. Companies that exclusively manage individual discretionary investment mandates must opt for investment firm status by 3 January. Companies managing AIFs below the authorisation thresholds set by AIFMD and individual discretionary investment mandates have until the same date to update their authorisation files.

From 3 January of next year, investment firms and asset management companies managing individual discretionary investment mandates will no longer be able to keep retrocession fees. They therefore need to act urgently to prepare for the arrival of this new model.

In product governance, entities providing investment services will be required to apply "distributor" rules. This means they will need to have suitable systems in place to understand the characteristics of products and assess their compatibility with clients' needs.

While management companies that engage only in collective investment activities do not have direct product governance obligations under MiFID 2, they will nevertheless have a role to play. Distributors of their products will be required to reach out to them for more information. This will be a way for them to sell their products more effectively and improve their competitiveness.

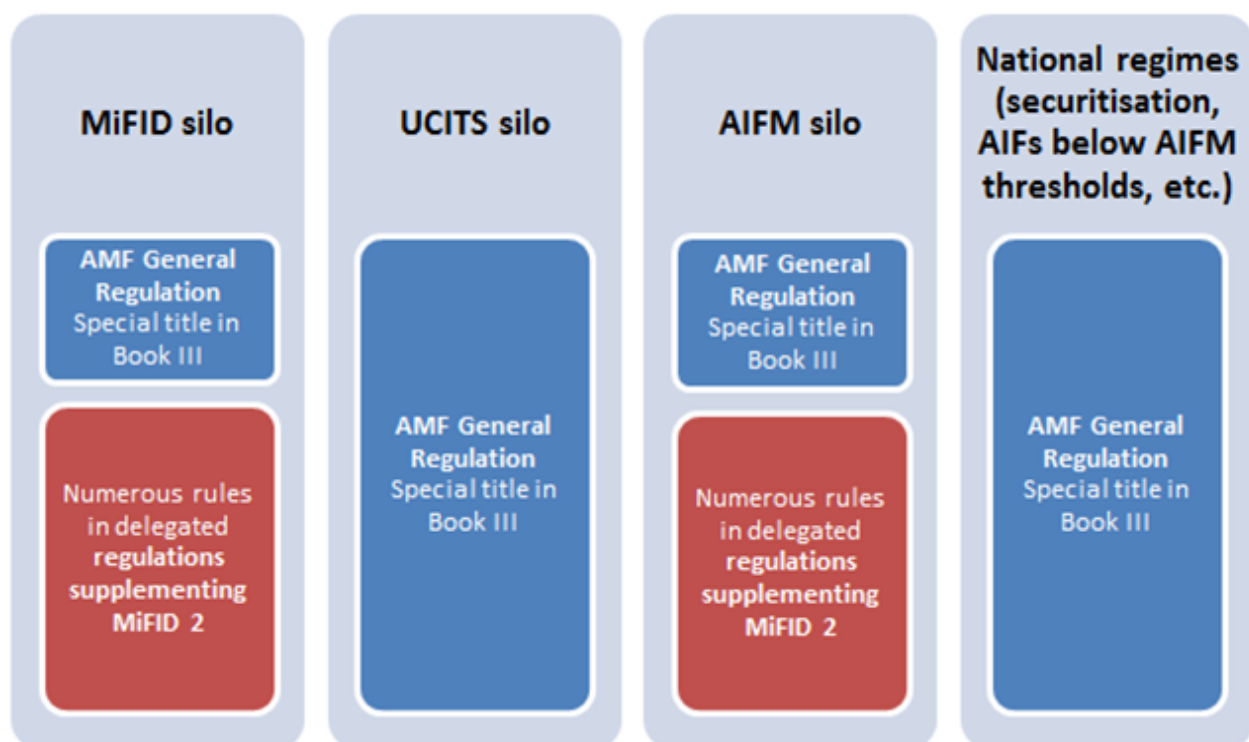
PRIIPs:

PRIIPs will also have consequences for the asset management sector beginning next January, with certain products, such as SCPIs, required to prepare a key information document. Management companies can also expect to be contacted by insurers, who will be affected by the new regulations as well. This will be the case when UCITS and AIFs are distributed in unit-linked form.

ESMA has published numerous Q&As and guidelines explaining how to apply Level 2 MiFID 2 and PRIIPs legislation.

I would like to take this opportunity to highlight the changes that are ahead for our own General Regulation between now and 3 January. To make the General Regulation more reader-friendly, a clearer distinction is going to be made between different activities and statuses, e.g. investment services providers other than asset management companies, UCITS management companies, AIF management companies, and so on.

New architecture for regulatory texts applicable to ISPs and AMCs



Are there other European issues that management companies should be keeping an eye on?

Yes. I would like to single out two: securitisation and the new Money Market Funds Regulation.

An agreement was reached in Brussels in May 2017 on a new European Regulation that creates a general framework for European securitisation and a label for simple, transparent and standardised (STS) securitisation. The regulation, which comes into effect on 1 January 2019, sets out the due diligence tasks that regulated investors must carry out before making securitisation investments, along with stress-testing requirements. The creation of data repositories containing information from securitisation participants will help to enhance transparency on this market.

Through self-certification by industry participants, the new Simple, Transparent and Standardised (STS) securitisation label is designed to restore investor confidence by providing assurance that securitisations are soundly structured and making sure that information is available to allow investors to properly analyse the underlying risks. Banks will also benefit through lower capital charges.

The new European Money Market Funds (MMF) regulation will harmonise at European level the rules applicable to such funds. It will apply to UCITS and AIFs established, managed or

marketed in the Union, beginning in July 2018 for new funds and January 2019 for existing funds.

To mitigate liquidity risks, especially in the event of large-scale investor redemptions, and the risks of spillover to other financial participants, the regulation sets minimum thresholds for liquid assets and diversification along with new asset valuation rules. It also prohibits financial support from credit institutions.


On the risk management front, the MMF regulation introduces requirements covering liability reporting and stress-testing of assets and liabilities. Asset management companies are additionally required to check the credit quality of securities held in the portfolio using an internally-developed methodology that they must put in place.

In the coming months, the AMF will support management companies during the process of authorising MMFs in accordance with the new regulation.

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