AUTORITÉ DES MARCHÉS FINANCIERS

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The underperformance of a mutual fund is not enough to characterise mismanagement

Retail local investment funds (FIPs) are designed to support the development of regional SMEs. They are retail private equity investments with a regulatory life span of generally 8 to 10 years, during which period redemption is only allowed in specific situations. It may happen that at the end of the life of the retail local investment fund, the sale of the units does not result in the final repayments expected by the investors, who may be all the more disappointed since their funds have been locked up over a long period. When this happens, they may challenge the fund management companies or marketing institutions on the grounds that the performance of these products is unsatisfactory.

I regularly receive requests for mediation concerning disputes based on this issue. This mediation case serves as a good illustration of this issue.

The facts

Mr A. subscribed to units in a retail local investment fund with his financial institution in 2009, 2010, 2011 and 2012.

This investor informed me that at the time of subscription, these investments were presented to him as profitable and tax-efficient. However, the investment had not performed as expected by the time it matured, and Mr A. estimated his capital losses at several thousand euros.

He therefore asked his institution, in its capacity as marketer, to compensate him for his losses. He did not receive any reply, and this led Mr A. to seek my intervention.

It should be noted that a retail local investment fund is a private equity fund whose objective is to take stakes in small companies in order to finance their start-up stage, development or transfer. FIPs invest at least 60% of their capital in unlisted regional SMEs, and can be very risky investments since the development prospects of the companies in which the funds invest are uncertain. Furthermore, securities of unlisted companies are not liquid. Since they cannot be traded on the financial markets, selling them may take several months.

In return for this lack of liquidity and the high risk of capital loss, subscribing to FIP units offers an attractive tax incentive in the form of a tax reduction, provided that the units are held for a minimum of five years.

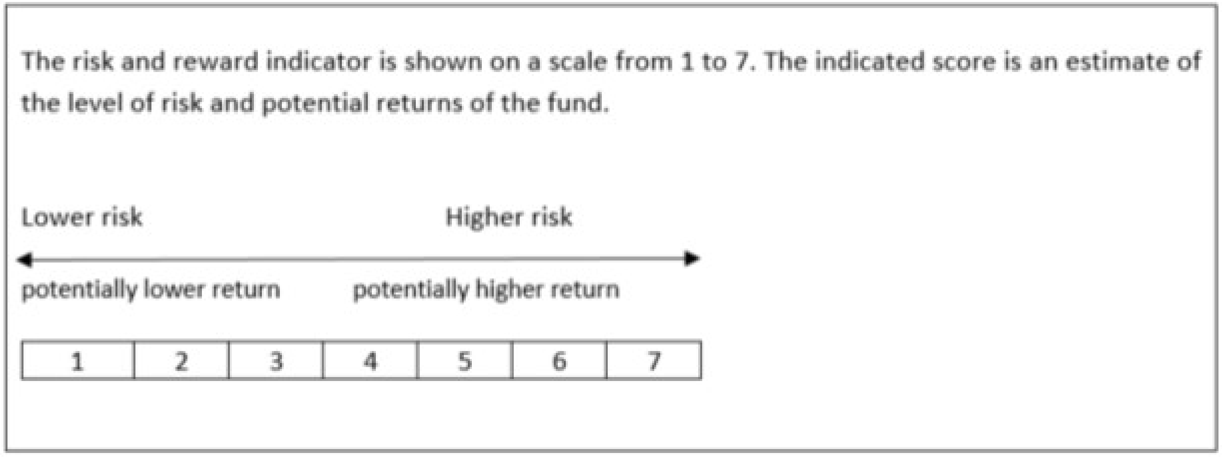
The investigation

On reading Mr A.'s application, I noted that, in contesting the underperformance of the FIPs he had subscribed to, he argued both that he had not received enough information at the time of subscription, and that the product had been poorly managed during its lifetime.

Regarding the lack of information, I questioned Mr A.'s financial intermediary through whom the funds were purchased and examined this file in the light of the information he provided me.

I obtained copies of the subscription forms for the retail local investment funds concerned and verified that Mr A. had acknowledged that he had read the information contained in the prospectus that had been given to him beforehand. I could not, therefore, reproach the marketing institution with any breach.

I then consulted the prospectuses and Key Investor Information Documents (KIIDs) of these retail local investment funds and found that each of these documents mentioned that there was a significant risk of capital loss that could lead to the loss of the entire capital. In particular, I noted that the risk indicator for the FIP underwritten was 7/7, i.e. the maximum risk, and that it was expressly stated that: "Private equity funds such as retail venture capital funds and retail local investment funds carry a high risk of capital loss. Fund performance is not guaranteed and the investor may not receive back all or part of the capital invested. ”



It was therefore clear that Mr A. had been warned of the particular financial risks to which he was exposed when he subscribed to units of the retail local investment fund. Mr A. had subscribed to these units with the main aim of benefiting from the tax advantages associated with holding retail local investment fund units. These advantages counterbalance the financial risks taken in focusing his savings on financing the local economy.

On the question of the financial loss suffered by Mr A., it should be noted that the product marketer is not involved in the management of the fund, which is the responsibility of the management company. Any complaints about the performance of such a fund should therefore be addressed to the management company in charge of it, and not to the marketing institution.

In any case, it should be noted that the poor performance of a fund and the recognition of unrealised losses do not, in themselves, establish that there was a fault in the management of this fund. This is because a management company has complete freedom of action, provided that it meets the management objectives of the funds. Only wrongful conduct and proof that it did not act in the interest of the holders could make it liable. However, it is up to the client, and not the professional, to gather the evidence to establish that poor management, attributable to the management company, caused the capital loss.

Recommendation

In view of the elements in my possession, the evidence found led me to consider that the marketing institution had not committed any breach in this case at the time of subscription. Mr A. was able to subscribe to the retail local investment fund units in full knowledge of the risk of capital loss. Moreover, he had no evidence to show that the management company was at fault in the management of the fund, and he had not filed a prior complaint with the company.

Lesson to be learned

It may therefore happen at the end of the product's life that its dissolution does not result in the expected refund amount.

When subscribing to retail local investment fund units, investors should be aware that this is an illiquid investment with a high risk of capital loss, offset by a substantial tax advantage. The Ombudsman's investigation, which involves an examination of the documents that the marketer must produce, may sometimes reveal that insufficient information has been provided on these risks.

Nevertheless, the observation of unsatisfactory performance is not sufficient in itself to prove poor management of the fund by the manager, which has nothing to do with the marketer. The burden of proof is then on the client, which is often difficult to provide.

Since the AMF Ombudsman's role is to settle disputes out of court, I have to rely on the information provided to me by the parties. In the absence of sufficient evidence, mediation cases that challenge fund management solely on the grounds of poor performance often have an unfavourable outcome for holders.

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