

## Investment funds in France: regulatory overview

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### RETAIL FUNDS

#### 1. What is the structure of the retail funds market? What have been the main trends over the last year?

##### Trends

The number of French investment management companies licensed by the Financial Markets Authority (*Autorité des Marchés Financiers*) (AMF) has almost doubled, from 350 in 1999 to 613 in 2013 (*French Asset Management Association (Association française de la gestion financière) (AFG), L'industrie française de la gestion d'actifs, March 2014*).

In December 2013, the amount of French assets under management increased by 1.2% compared to 2012, to EUR1,309 billion (*Autorité des Marchés Financiers, 2013 key figures and highlights; Autorité des Marchés Financiers, Facts & figures 2012*).

At the same time, the number of funds decreased by 3.25% compared to 2010, to 11,798 funds according to the AMF, including:

- One-quarter undertakings for collective investment in transferable securities (UCITS).
- Three-quarters alternative investment funds (AIFs) (*AFG, L'industrie française de la gestion d'actifs, March 2014*).

The main changes over the past year have been the:

- Implementation into French law of the provisions of Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) in July 2013 by Order 2013-676 of 25 July 2013, Decree 2013-687 of 25 July 2013 and Order of 8 August 2013 authorising amendments to the AMF General Regulations. This resulted in an overhaul of the relevant provisions of the French Monetary and Financial Code.
- AMF General Regulations (General Regulations).

With the implementation into French law of the AIFM Directive, the legal environment relating to retail funds has changed dramatically. A number of competitiveness measures have been taken to make French collective investment products more attractive. These measures have notably included:

- A simplification of the range of collective investment products, restricting use of the term UCITS to those collective investment schemes subject to Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS) (UCITS IV Directive).
- In-depth changes to fund names to facilitate comparisons between products at the European level. For example, the label OPCVM (*organisme de placement collectif en valeurs mobilières*) (the French translation for UCITS), previously used in relation to both UCITS and non-UCITS compliant funds, can now only be used to designate UCITS.

The retail fund market is now divided into the following main categories:

- UCITS (known as OPCVMs) which include:
  - Unincorporated open-ended funds (*Fonds Communs de Placement*) (FCPs); and
  - open-ended investment companies (*Sociétés d'Investissement à Capital Variable*) (SICAVs).
- AIFs available to non-professional clients. These include all open-ended or closed-ended retail investment funds, with the exception of UCITS, namely:
  - general purpose investment funds (FCPs or SICAVs);
  - venture capital funds (*Fonds communs de placement à risque*) (FCPRs);
  - innovation common investment funds (*Fonds Communs de Placement dans l'Innovation*) (FCPIs);
  - local investment funds (*Fonds d'Investissement de Proximité*) (FIPs);
  - retail real estate collective investment schemes (*Organisme de Placement Collectif Immobilier*) (OPCIs);
  - property investment companies (*Sociétés Civiles de Placement Immobilier*) (SCPIs);
  - forestry investment funds (*Sociétés d'Epargne Forestière*) (SEFs);
  - closed-ended investment companies (*Sociétés d'Investissement à Capital Fixe*) (SICAFs); and
  - alternative funds of funds.

In France, the majority of retail funds are open-ended funds. Closed-ended funds are limited both in nature and in volume.

##### Open-ended retail funds

The two main types of open-ended collective investment schemes are (*see Question 8, Open-ended retail funds*):

- FCPs.
- SICAVs.

##### Closed-ended retail funds

A closed-ended vehicle is one that is not subject to the obligation to issue and redeem shares at the request of the bearer (*Article L. 214-43, Monetary and Financial Code*). The main category of closed-ended fund is the closed-ended investment company (SICAF) (*see Question 8, Open-ended retail funds*). Securitisation schemes known as OTs (*organismes de titrisation*) are also closed-ended funds. OTs are intended to replace former receivable funds (*Fonds Communs de Créances*) (FCC) which can no longer be created (*Article L. 214-42-1, Monetary and Financial Code*).

While a SICAF can in theory be used as a retail product, there are only a handful of SICAFs on the market. OTs, because of their specific nature, are not retail products.

## Regulatory framework and bodies

### 2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

#### Open-ended retail funds

**Regulatory framework.** The main provisions regulating retail investment funds are the:

- Monetary and Financial Code.
- General Regulations of the Financial Markets Authority (AMF) and its implementing instructions and recommendations.

**Regulatory bodies.** The AMF regulates all collective investment schemes complying with the European standards and intended for the general public. It also regulates French AIFs which are not compliant with the UCITS Directive.

In the performance of its duties, the AMF can, in particular:

- Adopt and implement its General Regulations, implementing instructions and recommendations.
- Grant individual authorisations such as licences for portfolio management companies (*see Question 3*).
- Carry out inspections and investigations.
- Impose sanctions and penalties for breaches of regulations or professional obligations (*Article. L. 621-15, Monetary and Financial Code*).

The AMF subsequently monitors each fund through its lifetime, including in relation to compliance with the regulations and quality of the information supplied to investors (that is, annual reports, newsletters or advertising documents). Particular attention is paid to commercial documents on products intended for the general public.

#### Closed-ended retail funds

**Regulatory framework.** The same rules apply as for open-ended retail funds (*see above, Open-ended retail funds*).

**Regulatory bodies.** The regulatory bodies are the same as for open-ended retail funds (*see above, Open-ended retail funds*).

### 3. Do retail funds themselves have to be authorised or licensed?

The Financial Markets Authority (AMF) authorises the creation, marketing and material modification of the following collective investment vehicles:

- FCPs or SICAVs compliant with the UCITS Directive (*see Question 1*).
- AIFs which do not comply with the UCITS Directive (*see Question 1*).
- Employee investment funds (*Fonds Communs de Placement d'Entreprise*) (FCPE) and open-ended employee shareholding investment companies (*Sociétés d'Investissement à Capital Variable d'Actionnariat Salarié*) (SICAVAS).
- Venture capital funds (FCPRs, FCPIs and FIPs).
- Real-estate collective investment schemes (OPCIs). These include limited liability real estate companies with variable capital (*Sociétés de Placement à Prépondérance Immobilière*) (SPPICAV).
- Other products including:
  - property investment companies (SCPIs); and

- companies for financing the cinema and audio-visual industry (*Sociétés pour le Financement de l'Industrie Cinématographique et Audiovisuelle*) (SOFICA).

For an overview of the different types of funds, see *Question 1, Trends*.

The AMF issues an authorisation for the creation of these products after checking, among other things:

- Compliance of the product with the regulations.
- That units or shareholders are properly informed:
  - through the information indicated in the regulatory documents; and
  - in the letters sent to clients when there is a material change to the strategy of the product they hold.

The AMF makes no judgment on whether the investment is appropriate.

UCITS created in and originating from other EU or EEA member states are not authorised by the AMF. However, they can only be marketed in France under the European passporting right and provided that the AMF has received and acknowledged receipt of a notification from the regulator in the home member state. The notification must contain both the:

- Key investor information document (KIID) in French.
- Designation of the UCITS correspondent and centralisation agent in France. The agent must be an authorised depository (*see Question 7*). The agent's role, which can be carried out on an ongoing basis or in relation to a particular event, includes:
  - dealing with subscription and redemption requests from French investors;
  - paying coupons and dividends; and
  - handling information provided to French holders.

The AMF does not issue authorisation for SICAFs. However, when SICAFs make a public offer, the AMF issues an approval stating that the prospectus for the public is comprehensive, easy to understand and that the information it contains is coherent (*Article L. 621-8-1, Monetary and Financial Code*).

## Marketing

### 4. Who can market retail funds?

#### Open-ended retail funds

The marketing of retail funds in France can take several channels. Since the implementation in France of Directive 2004/39/EC on markets in financial instruments (MiFID), the marketing of funds is a regulated activity restricted to:

- Investment service providers.
- Financial investment advisers (*conseillers en investissements financiers*).

There is no statutory or regulatory definition of marketing. However, the Financial Markets Authority (AMF) uses the concepts in the AIFM Directive to define marketing. The AMF takes the view that marketing means a direct or indirect offering or placement at the initiative of the fund manager or on behalf of the fund manager of units or shares of a collective investment scheme to or with investors domiciled or with a registered office in the Union (*AMF Position Paper No 2014-04 dated 30 June 2014*).

The AMF can control the marketing of the products on the French territory at any time. Following an offering or placement, the marketing of a collective investment scheme will be deemed to have taken place in France and to be continuing as long as holders of shares or units domiciled in France hold these.

Marketing will not be deemed to have taken place in France if the acquisition, sale or subscription of the shares or units of a collective investment scheme either:

- Result from the unsolicited request of the investor, point to a designated scheme, and are available for subscription by an investor.
- Take place within the framework of a discretionary portfolio management activity, provided that the shares or units can validly be part of the financial instruments that can be purchased by the portfolio manager.
- Take place within the framework of the financial management of another investment scheme, provided that the shares or units can validly be part of the financial instruments that can compose the assets of the other investment scheme.

Marketing of an AIF that does not benefit from the AIFM Directive passporting regime is prohibited unless the fund obtains a specific authorisation from the AMF.

Specific regulations apply to certain methods of marketing, such as financial solicitation (*démarchage*), which must take place in accordance with the rules contained in the Monetary and Financial Code (*Articles L.341-1 to L.341-17*).

There are limited specific requirements for the marketing of foreign retail funds locally (*AMF Communication, "Inventaire des dispositions françaises applicables à la commercialisation de parts ou actions d'OPCVM de droit étranger sur le territoire de la République française"*):

- Designation of the UCITS correspondent and centralisation agent in France (*see Question 3*).
- Payment of prescribed fees to the AMF.
- Transmission of certain information to the AMF on an annual or biannual basis.
- Preparation of a French version of the key investor information document (KIID).

#### Closed-ended retail funds

The same rules apply as for open-ended retail funds (*see above, Open-ended retail funds*).

### 5. To whom can retail funds be marketed?

#### Open-ended retail funds

There are no restrictions on the type of investors to whom an open-ended retail fund can be marketed. Any type of investor (individuals or legal entities) can subscribe to or acquire units or shares of UCITS with a general purpose, subject to any limitations in the fund's prospectus (such as a minimum subscription amount). Subscription to shares or units of UCITS may be restricted to a specific category of investors whose characteristics are defined in the prospectus, such as participants of a given life insurance contract or entities belonging to a specific group of companies (*Article 411-22, General Regulations*).

Similar rules apply to foreign funds licensed for marketing in France.

#### Closed-ended retail funds

A SICAF (*see Question 8, Closed-ended retail funds*) cannot offer securities to the public unless the value of each share is higher than EUR10,000. The purpose of this rule is to provide for minimum subscription amounts, such as the ones existing for certain UCITS (*see above, Open-ended retail funds*). If the price of the share is lower than EUR10,000, the shares of the SICAF cannot be subject to any financial solicitation, unless the targeted investors are qualified as defined in Article L. 411-2. II of the Monetary and Financial Code (*Article L. 214-132, Monetary and Financial Code*).

### Managers and operators

#### 6. What are the key requirements that apply to managers or operators of retail funds?

##### Open-ended retail funds

Retail funds must be managed by licensed portfolio management companies (PMCs). PMCs are licensed by and under the supervision of the Financial Markets Authority (AMF).

**Licensing requirements.** PMCs must satisfy the following requirements (*Article L. 532-9, Monetary and Financial Code and Article 312-3, General Regulations*):

- The PMC's registered office must be in France and its legal form must be suitable for its activities.
- The PMC's initial capital must be fully paid up and at all times its own funds must be a minimum of the larger of either:
  - EUR125,000; or
  - one-quarter of its annual overheads in the preceding year.
- The PMC's activities must remain within the scope of its licence, which can be extended over time.
- Unless specific circumstances apply, the PMC must be managed by at least two directors who must have a sufficiently good reputation and appropriate expertise to perform their duties. Both directors are responsible to the AMF for its effective management. Non-French nationals can be appointed, provided they:
  - are French residents;
  - speak French; and
  - have a professional knowledge of the French financial markets and financial regulations.
- At least one of the two responsible managers must work full time within the PMC.
- A compliance officer must be appointed to manage internal controls and ensure compliance with conduct of business and fair practice rules (*Article 313-66, General Regulations*). Small PMCs can outsource compliance to a third party.

**Supervision requirements.** The General Regulations set out conduct of business rules and professional obligations for PMCs.

The AMF can perform on-site inspections to ensure that PMCs work within the programme of activities allowed by the AMF licence. The AMF also ensures compliance with, among other things, organisational requirements, Chinese wall rules and internal control provisions.

These requirements are supplemented by professional organisations' codes of good conduct. Professional organisations must submit their codes to the AMF, which can approve all or part of them as professional standards. PMCs must join one professional association when licensed.

**Organisational rules.** Articles 313-1 to 313-77 of the General Regulations set out organisational rules that each PMC must comply with:

- A process for each activity to ensure it complies with the conditions and obligations derived from its licence or its professional duties.
- A process for listing any activities from which a conflict of interest with the clients' best interest may arise. This process must be suitable to the size of the company and its activities.
- Reasonable measures to maintain its activity, when outsourcing critical tasks.

### Closed-ended retail funds

The same rules apply as for open-ended retail funds (*see above, Open-ended retail funds*).

### Assets portfolio

## 7. Who holds the portfolio of assets? What regulations are in place for its protection?

### Open-ended retail funds

Under Articles L. 214-10 to L. 214-11 of the Monetary and Financial Code, the portfolio of assets for all open-ended retail funds (SICAVs and FCPs) must be held by a custodian, called a depository (*dépositaire*), separate from the PMC (*Articles L. 214-9 and L. 214-26-6, Monetary and Financial Code*).

The depository has the following responsibilities (*Articles 323-1 and 323-23, General Regulations*):

- Safekeeping of the assets.
- Returning of the assets.
- Processing subscription and redemption orders.
- Informing the PMC or the SICAV of the operations relating to the securities held on its account.
- Ensuring that the SICAV's or the PMC's decisions comply with the applicable legislation and regulation.

The following can be depositories:

- The French Central Bank (*Banque de France*).
- The Deposits and Consignments Funds (*Caisse des Dépôts et Consignations*).
- Credit institutions and investment management companies authorised to conduct custody account keeping activities for financial instruments.
- Insurance companies and capitalisation undertakings governed by the Insurance Code.

Institutions seeking to conduct depository activities for collective investment schemes must apply for an authorisation from the Prudential Supervision Authority (*Autorité de Contrôle Prudentiel et de Régulation*) (ACPR) to conduct custody account keeping activities. The Financial Markets Authority (AMF) is informed by the ACPR of authorisation applications and issues remarks on the programme of operations.

### Closed-ended retail funds

The same rules apply as for open-ended retail funds (*see above, Open-ended retail funds*).

### Legal fund vehicles

## 8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

### Open-ended retail funds

**Legal vehicles.** UCITS or general purpose AIFs can adopt two different legal forms:

- **Investment companies with variable capital (SICAVs).** A SICAV is an open-ended investment company. It is a share-issuing collective investment scheme with legal personality (a company). SICAVs are partly regulated by the general rules applicable to limited liability companies. Their capital is divided into shares, which are issued and repurchased at their net asset value on the shareholders' request. Duly licensed portfolio management companies (PMCs) generally manage SICAVs under an investment management agreement. However, a

SICAV can be self-managed (that is, managed by its board of directors or directorate).

- **Unincorporated open-ended funds (*Fonds communs de placement*) (FCPs).** An FCP is a type of collective investment scheme without legal personality that issues units. An investor who buys units has shared ownership of the securities but does not have voting rights and is not a shareholder. An FCP is established by a PMC, which manages its assets and represents them in relation to third parties, and a depository. An FCP is represented and managed, from an administrative, financial and accounting standpoint, by a single PMC, which is allowed to delegate these tasks.

**Advantages.** FCPs are the most common form of UCITS found in the French market.

**Disadvantages.** Running a SICAV can be more expensive than running an FCP, and the board's involvement in the investment policy can conflict with the role of the investment adviser.

### Closed-ended retail funds

**Legal vehicles.** A SICAF can only take the legal form of a limited liability company (*Article L. 214-127, Monetary and Financial Code*). Therefore, the provisions concerning limited liability companies in the Commercial Code apply, with some exceptions. The purpose of a SICAF is the management of a portfolio of financial instruments, deposits and liquidities, diversifying investment risks either directly or indirectly (*Article L. 214-147, Monetary and Financial Code*). Like a SICAV, a SICAF is a public limited company with traditional governance and control bodies (board of directors, shareholders' meeting and so on). A SICAF is managed by an asset management company (*Article L. 214-149, Monetary and Financial Code*). The subscription terms are set out in the SICAF prospectus. A SICAF can only make a public offer if the nominal value of its shares exceeds EUR10,000 (*Article D. 214-240, Monetary and Financial Code*).

**Advantages.** The most significant difference between limited liability companies and SICAF is that a SICAF can, at any time, increase its capital without having to comply with all the procedures required for limited liability companies. The only limitation is that when shares are issued at a price that is lower than the net asset value per share, the existing shareholders have a priority right if they wish to subscribe.

**Disadvantages.** The minimum initial capital of a SICAF is EUR8 million. The minimum investment amount for a SICAF is EUR10,000.

### Investment and borrowing restrictions

## 9. What are the investment and borrowing restrictions on retail funds?

### Open-ended retail funds

The investment and borrowing restrictions applicable to UCITS and general purpose AIFs are identical and contained in the Monetary and Financial Code.

### Investment restrictions

**Dealing with one issuer (5/10/40 rule).** No more than 10% of net assets of a UCITS can be invested in transferable securities or money market instruments issued by the same issuer (10% rule). Where investments in transferable securities and money market instruments of single issuers each exceed 5% of the net assets of a fund, they cannot in aggregate exceed 40% (40% rule) of the total net assets of the fund (5% rule). However, where a UCITS replicates an index recognised by the regulator, the 10% limit can be raised to 20% (or 35% if justified).

**Investing in UCITS or AIFs.** UCITS Fund of Funds can invest up to 20% of their net assets in a single UCITS fund or other eligible AIF. In addition, the following rules apply:

- Where the collective investment scheme is an umbrella fund, each sub-fund may be regarded as a separate scheme for the purposes of the 20% limit. This prohibition does not apply to a feeder UCITS investing almost all of its assets into a diversified portfolio of a master UCITS fund. However, these restrictions would apply to the master UCITS fund's strategy.
- A UCITS Fund of Funds cannot invest more than 30% of its total net assets in collective investment schemes that are not UCITS funds.
- A UCITS Fund of Funds cannot invest in any other fund that invests more than 10% of its assets in other funds ("funds of funds").

#### Borrowing restrictions

UCITS funds are subject to the following borrowing limits, the combined amount of which may not exceed 15% of the UCITS net assets:

- A UCITS fund can borrow up to 10% of its net assets to finance redemption requests from its investors, provided that the loan is on a short term basis;
- A UCITS fund can borrow up to 10% of its net assets for the acquisition of immovable property essential for the direct pursuit of its business (such as business premises).
- Despite the above, up to 100% of a UCITS fund's net assets can be leveraged through the use of financial derivative instruments. However, a UCITS must be in a position to pay back all its obligations at all times.

#### Other restrictions

A UCITS fund cannot:

- Invest more than 10% of its net assets in transferable securities and money market instruments which are not listed on a regulated market.
- Grant loans or act as guarantor to third parties.

#### Closed-ended retail funds

There are no legal or regulatory investment restrictions for SICAFs. The board of directors must determine the investment strategy it intends to pursue.

However, the Monetary and Financial Code provides for a principle of risk diversification (*Article L. 214-127, Monetary and Financial Code*). Therefore, a SICAF can invest all or most of its assets in one fund, but that target fund must comply with the principle of risk diversification.

### 10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

#### Open-ended retail funds

**Subscription.** Managers can restrict the subscription of shares to a category of investors whose characteristics are defined in the prospectus.

In addition, UCITS funds and general purpose AIFs can stop issuing units permanently or for a temporary period in objective situations defined in the fund's prospectus such as (*Articles L. 214-7-4 and L. 214-8-7, Monetary and Financial Code* for UCITS funds, *Articles L. 214-24-33 and L. 214-24-41, Monetary and Financial Code* for general purpose AIFs and *Article 411-20 and 422-21, General Regulations*):

- Reaching of a maximum number of shares or units issued.
- Reaching of a maximum amount of invested assets.

- Reaching of a set subscription period.

**Redemption.** Shares or units in UCITS (*Articles L. 214-7 and L. 214-8, Monetary and Financial Code*) and general purpose AIFs (*Articles L. 214-24-29 and L. 214-24-34, Monetary and Financial Code*) can be redeemed by the SICAV or the FCP at any time on request of the shareholders or unitholders (*Articles 411-20 and 422-21, AMF General Regulations*). However, a SICAV or FCP can temporarily suspend redemption of shares or units under its articles of association or internal regulations if both:

- There are exceptional circumstances.
- It is required in the unitholder's or shareholder's best interests.

The portfolio management company must notify the Financial Markets Authority (AMF) of the reasons and procedures for suspending redemptions (*Articles 411-20 and 422-21, General Regulations*).

The redemption of units is also suspended when the assets of an FCP or SICAV fall below EUR300,000 (*Articles 411-21 and 422-22, General Regulations*).

#### Closed-ended retail funds

**Subscription.** A SICAF cannot issue any new shares after the initial subscription period, unless there is an increase of the share capital. After the initial subscription period, an investor can acquire the SICAF's shares on the secondary markets.

**Redemptions.** The shares of a SICAF cannot be redeemed at the request of the investors, except in exceptional cases provided for in the SICAF's bye-laws (*Article L. 214-147, Monetary and Financial Code*). Subject to these limited exceptions, an investor can only sell shares on a secondary market.

Listed SICAFs can redeem up to 10% of their capital per year, or up to 25% if the price of the shares is 10% less than the net asset value of the shares (*Article L. 214-137, Monetary and Financial Code*). A general meeting of the SICAF can further authorise the redemption of more than 25% of the shares of the SICAF.

For an overview of the different types of funds: see *Question 1, Trends*.

### 11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

#### Open-ended retail funds

Shares or units of UCITS can be sold to other unitholders or shareholders, or to third parties. No active secondary market exists in relation to shares or units of funds, except as to index funds (trackers) and certain real estate AIFs (SCPIs).

#### Closed-ended retail funds

Non-listed SICAFs (*see Question 8, Closed-ended retail funds*) can impose restrictions on transfers, for example, approval clauses or pre-emption rights. Listed SICAFs cannot impose restrictions.

#### Reporting requirements

### 12. What are the general periodic reporting requirements for retail funds?

#### Open-ended retail funds

UCITS and general purpose AIFs must publish annual and biannual reports on the funds' assets (*Article D. 214-31-2 and D. 214-33, Monetary and Financial Code*). These reports must be published no later than two months after the end of the half-year (no later than four months for a UCITS annual report) and must be provided on request to investors at no cost.

Within six weeks after the close of each semester, UCITS must prepare an inventory of the assets under the control of the depository (*Article L. 214-17, Monetary and Financial Code*). They must also publish an asset composition document under the control of the funds' statutory auditors on the day of calculation of the last net asset value for the semester (*Article L. 214-17, Monetary and Financial Code*). This document is issued, on request of any shareholder or unitholder, within eight weeks of the end of each semester.

A UCITS organised as a SICAV must publish a profit and loss account, and a balance sheet, at least 30 days before the general meeting is convened for approval.

### Closed-ended retail funds

A SICAF (*see Question 8, Closed-ended retail funds*) must publish an inventory of its assets under the control of the depository within six weeks after the end of each semester (*Article L. 214-135, Monetary and Financial Code*). A SICAF must also prepare an asset composition document, under the control of the funds' statutory auditors, on the day of calculation of the last net asset value for the semester, along with a calculation of net asset value per share (*Article L. 214-135, Monetary and Financial Code*). This document is issued, on request of any shareholder or unitholder, within eight weeks of the end of each semester.

### Tax treatment

## 13. What is the tax treatment for retail funds?

### Open-ended retail funds

**Funds.** As FCPs do not have any legal personality, they are not liable to pay corporate income tax (CIT). The income distributed by an FCP is taxed at investor level. SICAVs fall within the scope of CIT, but they benefit from a full tax exemption (*see Question 8, Open-ended retail funds*).

**Resident investors.** Individual investors are subject to income tax on distributions received from an FCP or a SICAV. Individual investors are taxed as if they had directly received the distributed income (that is, with the benefit of the tax relief that usually applies to the different types of income distributed by the fund, such as dividends, interest, and so on).

They are taxable to income tax according to the specific rules for each category of income. In particular, dividends are subject to income tax at the progressive tax rates up to 45%, after the application of a 40% rebate. Before being taxed at the progressive tax rates, distributions are subject to a withholding rate of 21%. This down payment is a deposit of income tax due the following year and refundable in case of excess.

Capital gains realised on the sale or redemption of shares or units are subject to income tax at the progressive rates up to 45%. Capital gains can be reduced by an allowance which is applied depending on the length of time the shares or units have been owned.

Capital gains and distributions are also subject to social levies at the rate of 15.5%. In addition, the gains and distributions may be subject to the exceptional income tax for high earners at a marginal rate of 3% or 4%.

Corporate investors are subject to CIT at the rate of 33% on distributions they received from the fund and on capital gains realised on the sale of their shares (they cannot benefit from the long-term capital gains regime).

French companies subject to CIT are generally taxed on a mark-to-market basis (that is, on the difference between the net asset value of their shares or units at the beginning of the tax year and at the end of the tax year). The regular CIT rate is 33.33%. An additional

social contribution of 3.3% is due by certain companies whose CIT exceeds EUR763,000.

An exceptional contribution of 10.7% is also due by certain companies whose turnover exceeds EUR250 million. This can result in an overall CIT rate of 38%.

As an exception, corporate investors are not taxed on a mark-to-market basis when more than 90% of the fund's assets are shares issued by companies registered in an EU member state and subject to CIT or an equivalent tax.

**Non-resident investors.** As FCPs are transparent for tax purposes, there is no impact on the qualification and source of the income that they allocate to non-residents. Distributions may therefore be subject to a withholding tax in France, at a rate depending on the:

- Beneficiary (individual, corporate investor or other).
- Nature of the income.
- Source of the income.
- Country of payment of the income.

The rates range from 0% for foreign source income and French source interest, to 15% to 30% for French source dividend income and 30% to 75% on French source income paid in non-co-operative jurisdictions.

The same regime applies to the distribution made by a SICAV since the French tax authorities have adopted a look-through approach.

Capital gains realised by non-resident investors on the sale or redemption of their shares or units are generally not subject to withholding tax at source in France.

### Closed-ended retail funds

**Funds.** The rules are similar to those that apply to open-ended retail funds (*see above, Open-ended retail funds: Funds*). As a joint ownership structure without a legal personality, closed-ended private equity funds (FCPRs, FCPIs and FIPs) are not liable to CIT.

Under certain conditions, SICAFs benefit, during the first three years following their constitution, from a CIT exemption on capital gains and income derived from their portfolio's assets. After this three-year period:

- Listed SICAFs continue to benefit from the full exemption on income and capital gains.
- Non-listed SICAFs only benefit from a CIT exemption for capital gains.

**Resident investors.** Distributions received by individual investors from a SICAF are treated as dividends. The rules are similar to those that apply to resident investors of open-ended retail funds (*see above, Open-ended retail funds: Resident investors*). Social levies apply at the rate of 15.5%.

Capital gains realised on the sale or redemption of shares of a SICAF are subject to income tax with rules similar to those that apply to open-ended retail funds (*see above, Open-ended retail funds: Resident investors*).

Individual investors investing in a closed-ended private equity fund (FCPR, FCPI or FIP) benefit, under certain conditions, from an income tax exemption on distributions and capital gains derived from their investment (except social levies of 15.5%). In addition, under certain conditions, individual investors investing in an FCPI or a FIP are entitled to a tax credit equal to 18% of the subscription price. This tax credit cannot exceed EUR24,000 for a married couple and EUR12,000 for a single person.

Corporate investors are subject to CIT at the rate of 33% on distributions they received from a SICAF or a closed-ended private equity fund.

Capital gains realised by corporate investors on the sale of shares of FCPI are subject to CIT at the rate of 33% and cannot benefit from the long term capital gains regime.

Capital gains on the FCPI's shares' sale benefit, under certain conditions (after a minimum holding period of five years), from an exemption, up to the underlying assets of the fund represented by participating shareholdings held for more than two years. The exceeding portion is taxable at 15%.

The French tax authorities have not indicated if the mark-to-market rule applies to corporate investors in a SICAF. A tax relief is available for corporate investors in an FCPI or a FIP, although these funds are generally designed for retail investors.

**Non-resident investors.** Similar rules apply as for open-ended retail funds (see above, *Open-ended retail funds: Non-resident investors*).

For an overview of the different types of funds: see *Question 1, Trends*.

### Quasi-retail funds

#### 14. Is there a market for quasi-retail funds in your jurisdiction?

There is no market for quasi-retail funds.

### Reform

#### 15. What proposals (if any) are there for the reform of retail fund regulation?

On 25 February 2014, the European Parliament and the Council backed the European Commission's proposal to strengthen the rules for UCITS following the adoption by the European Commission in July 2012 of a proposal for a directive amending the UCITS IV Directive in the areas of depository functions, remuneration policies and sanctions with the aim of strengthening the protection of investors.

Directive 2014/91/EU on undertakings for collective investment in transferable securities (UCITS) as regards depository functions, remuneration policies and sanctions (UCITS V Directive) was adopted by the European Parliament and the Council of the EU on 15 April 2014 and 23 July 2014 respectively and was published in the Official Journal of the EU (OJ) on 28 August 2014. The UCITS V Directive came into force on 17 September 2014 and member states have until 18 March 2016 to transpose it into national law. The new legislation will be implemented in France and may further impact the retail fund regulation.

### HEDGE FUNDS

#### 16. What is the structure of the hedge funds market? What have been the main trends over the last year?

The transposition of the AIFM Directive into French law in July 2013 has significantly changed the legislative and institutional framework for asset management, especially the hedge fund industry. With a revised list of vehicles and new marketing rules, the legal and regulatory landscape has drastically evolved over the past year.

French hedge funds can be found in two categories of AIFs:

- AIFs available to non-professional clients for alternative funds of funds.
- AIFs available solely to professional clients for all other hedge funds.

### Regulatory framework and bodies

#### 17. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

##### Regulatory framework

The rules are similar to those that apply to open-ended retail funds (see *Question 2*).

##### Regulatory bodies

Hedge funds are regulated by the same bodies as retail funds (see *Question 2*).

#### 18. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

French hedge funds are largely regulated and set the norm for international standards of good practice. Even before the enactment of the AIFM Directive, French hedge funds and their management companies had to follow a set of rules.

Legal vehicles used to set up hedge funds and rules applicable to these funds are the same as those used for retail funds (see *Questions 2 and 8*).

##### Risk

Risk is controlled through the ratios applicable to the funds and the type of financial instruments that they can purchase. For example, funds of hedge funds may invest more than 10% of their assets in other hedge funds and are subject to the 5/10/40 diversification rules (*Article R. 214-186, Monetary and Financial Code*) (see *Question 9*).

The portfolio management companies (PMCs) managing these funds must be licensed by the Financial Markets Authority (AMF) with a specific programme of activity relating to the use of specific financial instruments (for example, complex derivatives and credit derivatives). There must also be a risk controller within the management company.

##### Valuation and pricing

The hedge fund's PMC or an independent expert must publish the net asset value and communicate it to any person on request. During its review of a PMC's licence, the AMF must ascertain that the PMC has the necessary technical means to evaluate assets under management. The frequency with which net asset value is calculated and published depends on the type of fund.

##### Systems and controls

Controls include the following:

- **Internal control.** The PMC must have a suitable internal structure in place to supervise and monitor its activities, and ensure compliance with ethical rules (*Article 318-1, General Regulations*). To implement this control, the PMC must appoint a compliance and internal control officer, who is in charge of compliance and continuous and periodic monitoring (*Article 318-5, General Regulations*).
- **Depository.** The fund's depository controls the PMC's decisions and must ensure that the hedge fund complies with the law and its bye-laws or internal regulations (*Articles L. 214-24-3- L. 214-24-12, Monetary and Financial Code and Article 323-23, General Regulations*).
- **Audit.** The auditor constitutes another level of control of the hedge fund.

Hedge funds are also required to give periodic information to investors and regulators.

### Insider dealing and market abuse

Hedge funds and their PMCs are subject to the standard rules relating to insider dealing and market abuse, breach of which can result in criminal prosecution and/or administrative proceedings before the AMF.

### Transparency

Hedge funds must report to investors and regulators in the same manner as retail funds (*see Question 12*).

### Money laundering

Hedge funds and their PMCs are subject to the standard money laundering regulations (*Articles 315-49 to 315-58, General Regulations*). For example, the management company must:

- Obtain and verify the identity of any investor before entering into an agreement with them.
- Examine any unusual or complex transaction that appears to have no economic justification.
- Report suspicious amounts and transactions.
- Maintain written records of its monitoring activity.

These requirements can be adapted to suit the PMC's marketing, particularly where the PMC has no direct relationship with the investors.

### Short selling

French regulations provide for transparency requirements in relation to net short positions giving rise to an exposure to the issued share capital of companies admitted to trading on a regulated market or an "organised" multilateral trading facility (MTF) (*Article 223-37, General Regulations*).

This disclosure obligation applies to net short positions related to shares admitted to trading on a French regulated market (for example, NYSE Euronext Paris) or a French organised MTF (for example, Alternext Paris) and for which that market is the reference market.

In addition, the AMF is entitled to take extraordinary measures in the event of exceptional circumstances that threaten the stability of financial markets. These measures may concern restrictions on the conditions of negotiation of securities, in particular the prohibition of short selling regarding certain securities (*Article L. 421-16-II, Monetary and Financial Code*).

### Marketing

#### 19. Who can market hedge funds?

The persons entitled to market units or shares of hedge funds are the same as for retail funds (*see Question 4*).

#### 20. To whom can hedge funds be marketed?

The persons to whom hedge funds can be marketed vary depending on the nature of the hedge fund.

Professional funds with general purpose can be marketed to investors fulfilling the criteria of Article 423-2 of the General Regulations (such as professional investors, states and central banks). Their minimum initial subscription is EUR100,000.

Specialised professional funds can be marketed to professional investors under the MIFID Directive, who may invest a minimum initial subscription of EUR100,000.

Funds of hedge funds can be marketed to non-professional investors. They are subject to specific investment restrictions set out in Article R. 214-186 of the Monetary and Financial Code (Code).

Qualified investors are listed in Article D. 411-1 of the Code. They include professional clients within the meaning of Article L. 533-16 and eligible counterparties within the meaning of Article L. 533-20. Professional clients include clients meeting the criteria of Article D. 533-11 of the Code, such as:

- Banks.
- Investment service providers.
- Insurance companies.
- Investment funds and their portfolio management companies (PMCs).
- Other regulated establishments.

Eligible counterparties are listed in D.533-13 of the Code and include the same persons as professional clients (*see above*).

### Investment restrictions

#### 21. Are there any restrictions on local investors investing in a hedge fund?

Local investors can invest in French hedge funds provided they meet the conditions set out by French regulations (*see Question 20*).

### Assets portfolio

#### 22. Who holds the portfolio of assets? What regulations are in place for its protection?

Similar rules apply as for retail funds (*see Question 7*).

### Requirements

#### 23. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

In general, hedge funds must submit a prospectus to the Financial Markets Authority (AMF) for approval that discloses the characteristics and the risks linked to the investment and a specific warning about the inherent risks.

Specialised professional funds give a simple notification to the AMF no later than one month after their creation (*Instruction DOC-2012-06*).

#### 24. What are the key requirements that apply to managers or operators of hedge funds?

Managers of hedge funds are subject to the same licensing, supervision and organisational requirements as for retail funds (*see Question 6*).



**Legal fund vehicles and structures****25. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?**

Legal vehicles used to set up hedge funds are the same as those used for retail funds (*see Question 8*).

**Tax treatment****26. What is the tax treatment for hedge funds?****Funds**

Hedge funds are taxed in the same way as retail funds (*see Question 13*).

**Resident investors**

Hedge funds are taxed in the same way as retail funds (*see Question 13*).

**Non-resident investors**

Hedge funds are taxed in the same way as retail funds (*see Question 13*).

**Restrictions****27. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?****Redemption of interest**

In principle, shares or units are redeemable on request, although the restrictions that apply to retail funds also apply to hedge funds (*see Question 10*).

**Transfer to third parties**

Transfers of shares or units of a hedge fund are only subject to the transferor being an eligible investor to the relevant vehicle (*see Question 19*). Additionally, transfers to third parties may be subject to the PMC's prior approval, if the prospectus so provides.

**Reform****28. What (if any) proposals are there for the reform of hedge fund regulation?**

To date, there are no proposals for the reform of hedge fund regulation.

**ONLINE RESOURCES****Legifrance**

W [www.legifrance.gouv.fr](http://www.legifrance.gouv.fr)

**Description.** French government entity responsible for publishing legal texts online. The information provided on this website is up-to-date. English translations available at [www.legifrance.gouv.fr/Traductions/en-English](http://www.legifrance.gouv.fr/Traductions/en-English). The translations have no legal force, and are provided for informational purposes only.

**Financial Markets Authority (AMF)**

W [www.amf-france.org/en\\_US](http://www.amf-france.org/en_US)

**Description.** The AMF is the French financial markets regulator. The information provided on this website is regularly updated.

**French Asset Management Association (AFG)**

W [www.afg.asso.fr](http://www.afg.asso.fr)

**Description.** Founded in 1961, the AFG represents and promotes the interests of the French asset management industry, both for collective and for discretionary portfolio management.

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## Practical Law Contributor profile

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