Opinion Leaders

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In this month's issue:

EDITORIAL

Coming in the middle of serious and numerous developments in the complex subprime crisis, recent frauds – which are on an unprecedented scale and go a little bit further in undermining the shaky confidence in our institutions and financial regulations – call the asset management industry into question and make it urgent to identify the causes of these disasters and the ways and means of rectifying them.

We can assume that time and a lot of money will be needed for the lessons of these events to be fully learnt. But at the same time a multitude of complex regulatory issues need to be addressed, at a European and global level, and work already begun must be accelerated… all while reassessing and retuning them in light of events. An enormous task!

From a European viewpoint, these cases have already exposed the lack of harmonization in the regulatory framework for collective management, which, for coordinated investment funds (UCITS), means a Directive dating from 20 December, 1985 (as amended). Discussions and work in progress has therefore focused on the issue of the fund depositor's liability, which article 9 of the UCITS Directive states is determined "according to the national law of the State in which the registered office of the management company is based".

Yet, as well as these technical questions, legitimate questions can also be raised about the circumstances in which (apparently) shares in foreign funds which are neither regulated nor managed by certified entities, nor subject to the principle of separation of management and ownership functions came to be invested in coordinated UCITS freely marketed in France, including to the general public, and some "non traditional" financial products including in particular put and call and over-the-counter or OTC.

Jean L'HOMME

Partner

Investigations and procedures currently underway should shed light on this point. We can observe however that the third "batch" of reforms to the UCITS Directive, known as UCITS III1, accompanied by Directive 2007/16/EC of 19 March, 2007 covering eligible assets, paved the way for a measure of "convergence" in traditional management (long only) and alternative management – which uses sophisticated financial techniques and involves a great or lesser amount of risk, such as short selling. Coordinated investment funds, eligible for the European "passport", were thereby explicitly authorized to invest in a series of products far removed from traditional "securities", such as money-market instruments, shares in other UCITS (whether coordinated or not), derivatives and over-the-counter type products (OTC), as well as index-linked funds and products.

Although UCITS III rules include restrictions in terms of investment ratios and use of leverage, the accessibility now offered to coordinated UCITS to "sophisticated" financial techniques and instruments, often originating in the alternative management sector, undoubtedly had the effect of weakening the boundary between the (general public) retail investments naturally invested in these structures (UCITS), and alternative investments, with little or no regulation, normally reserved for qualified investors, professionals or at least the “well informed”2. Such are the ways of financial innovation…

These developments point to the risk of retailization (or penetration of sophisticated and risky financial techniques and instruments in the general public or retail savings sector), which is also demonstrated however in the context of UCITS funds’ competitor products, such as "index-linked certificates" (or other structured products), sometimes marketed under the Prospectus directive, or even life insurance policies in units of account (excluded, like collective management, from the field of the MiFID Directive).

According to a study published in February 20083, since 2007 and the publication of the directive on eligible assets, an increase has been observed in the creation of coordinated funds which are "sophisticated […] and whose impact on risk incurred still needs to be analyzed”, while operating risk has undeniably increased4.

Yet for the past three years the European Commission has carried out research and work which has resulted in a fourth "batch" of reforms5 to the

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[1] Directives 2001/107/EC and 2001/108/EC, amending UCITS Directive 85/611/EEC, which came into force on February 13th, 2004.

[2] It should be noted in passing that one of the main expected effects of the current work to develop a European private investment system will be to facilitate the marketing to “qualified” investors of shares in uncoordinated foreign funds.

[3] “Investment funds in the European Union: Comparative analysis of use of investment powers, investment outcomes and related risk features in both UCITS and non-harmonised markets” – Pwc.

[4] The study nonetheless maintains that directors, aware of their responsibility in relation to retail clients, develop sound risk management procedures before launching complex new products.

[5] On 13 January 2009 the European Parliament adopted this fourth "batch", which cannot be implemented, however, until after formal adoption of the Directive by the Council and its transposition into member states’ legislation, which is due to happen before 1 July, 2011.

UCITS Directive, known as UCITS IV, aiming in particular to facilitate the consolidation of the sector and the expected economies of scale, especially by authorizing cross-border mergers of investment funds and providing management companies with an effective "passport" allowing them to set up and manage funds on a cross-border basis.

Apparently implementation of the UCITS IV reform will complicate the structuring of fund bodies' and providers' activities as well as the surveillance duties of regulatory authorities. In this context, coordinated UCITS' harmonized management rules need to be deepened and strengthened, as do rules governing their marketing.

But in order to preserve, if not restore, the brand image of funds in the UCITS stable, whose marketing reach extends beyond Europe in particular, to Asia and Latin America, it is vital that a concerted and rigorous approach be implemented to improve control of operating risks. Perhaps regulation through principles has, according to some, had its day, but its consequence, making intermediaries more responsible, is more relevant than ever.

Legal and Tax Watch

Wealth tax holding companies: will there be a new shake-up of the system?

The draft amended 2009 Finance Act has just been adopted after its first reading in the French National Assembly. It partially went back on the amendment which was adopted last December at the initiative of Senator Adnot as part of the 2009 Finance Act.

The amendment obliges wealth tax holding companies to comply with the following additional conditions:

- not to have more than 50 shareholders or unit holders, and
- to have only natural persons as corporate offices, and
- not to provide any capital guarantee to its shareholders in consideration for their subscriptions nor any automatic exit arrangements at the end of five years.

These terms and conditions, applicable from the 2010 wealth tax campaign, will be commented on in a fiscal notice to be published shortly.

As part of the amended 2009 Finance Act, member of parliament Mr Forissier had an amendment adopted modifying these conditions: the limit of 50 shareholders will not apply to holding companies which invest in small companies less than 10 years old. Small companies are defined as those employing less than 50 employees and achieving a maximum annual turnover of €10m. The fiscal benefit would then be calculated by using the payments made by the holding to such companies. If this clause is confirmed, it will also apply from the 2010 wealth tax campaign. Its effect will be to enable holding companies to make public offerings on condition they invest in these targets.

Mr Forissier also supported an amendment aiming to remove the condition relating to the absence of legal entity corporate officers from "providential investors' management companies". This amendment was not adopted by the Budget minister promised to look into the question in relation to examination of the draft law by the Senate. This is expected to take place from 31 March.

The draft law should be permanently adopted on 9 April, 2009. It is likely that publication of the fiscal notice commenting on the Holding company system will be delayed until the end of the parliamentary debates.

Legal News

New rules governing public offerings come into force

The order of 22 January 2009 governing public offerings will come into force on 1 April, 2009. The notion of "public offering" is replaced by that of "public offers of securities" and "admission to trading on a regulated market".

The public offer is either the result of:

- a communication sent to people in any form and by any means and presenting sufficient information about the conditions of the offering and the securities being offered as to enable the investor to decide to buy or subscribe to those financial securities;
- or an investment in financial securities through financial intermediaries.

However, as a result of the size of the offer or its intended recipients, the offer may avoid definition as a public offer. For instance, one outcome of the draft amendment to the French financial markets authority [AMF] General Regulations, which were subject to consultation until 13 February, is that the offer need not qualify as a public offer when:

- it amounts to less than €100,000,
- its total amount is between €100,000 and €2,500,000 and relates to at least 50% of the issuer's capital,
- each of the investors subscribes to at least €50,000,
- the nominal value of the securities is at least €50,000.

Similarly, offers addressed exclusively to companies supplying portfolio management investment services on behalf of third parties, qualified investors or a restricted circle of investors, do not constitute a public offer.

The order goes on to put an end to doubt over the ability of a simplified joint-stock company to make use of private placement. For part of this approach considers that only companies authorized to make public offerings (public companies and limited partnerships) can benefit from exemptions to public offerings. Remembering that simplified joint-stock companies cannot be listed on a regulated market, the order authorizes simplified joint-stock companies to fall back on private placement of their shares. But they do not benefit from all the exemptions to public offers: if the private placement of simplified joint-stock

company shares is not authorized except in the event that the offer is aimed exclusively at those persons stipulated above (qualified investors, etc.) or those who invest at least €50,000 per investor, it does not benefit from exemptions linked to the total amount of the offer or the percentage of the capital offered.

Partnership contracts: publication of implementing legislation

Several pieces of implementing legislation for act no 2008-735 of 28 July, 2008, relating to public-private partnership contracts appeared in the Journal Officiel of 4 March, 2009:

- decree no 2009-242 stipulates the contents of the annual report, produced by the co-contracting party, is presented by the executive of the local government or public body, to allow the contract's fulfillment to be monitored. It also states the conditions for granting certain public contracts.
- decree no 2009-243 deals mainly with the public notices which contract agreements must make, information that public bodies must demand of applicants, the call for tenders procedure, etc;
- decree no 2009-244 relating to procedures for applying of the French Local Government Code and article 48 of Act no 2008-735 of 28 July, 2008, also sets out the rules for public notices applicable to contract agreements;
- decree no 2009-245 defines small and medium-sized companies in the regulations applicable to public procurement which obliges some public bodies to commit to awarding a proportion of their contracts' fulfillment to SMEs;
- a ruling of 2 March 2009 defines the assessment methodology to use prior to implementing a procedure to award a partnership contract.

Decree no 2009-267 of 9 March 2009 relating to accounting obligations of commercial companies

For financial years starting after 13 March 2009 commercial companies must ensure they append the following information:

- "*the commercial nature and objective of transactions not recorded in the financial statement, on condition that the resulting risks and benefits of these transactions are significant and provided that disclosure of these risks and benefits is necessary to assess the company's financial situation*";

- for public companies which adopt a simplified presentation, "*the list of transactions carried out between, on the one hand, the company and its principal shareholders and, on the other, the company and the members of these administration and monitoring bodies, if these transactions are of significant importance and have not been agreed under normal market conditions"*;

- for those which cannot adopt a simplified form, "*the financial impact of certain transactions not recorded in the financial statement as well as*

the list of transactions carried out with associated parties when these transactions are of significant importance and have not been agreed under normal market conditions".

Decree no 2009-234 of 25 February 2009 including various measures aimed at simplifying the way some forms of company operate

The decree sets out the conditions for using videoconferencing and telecommunications methods and cases in which simplified joint-stock companies need to appoint a statutory auditor.

Decrees relating to procedures for applying order no 2009-15 of 8 January 2009 relating to financial instruments

Two decrees dated 16 March 2009 set out the conditions for applying the order relating to securities and financial contracts. They stipulate that financial securities are not effective until they are recorded in their owner's accounts. When the securities account is held by the issuer, the financial securities take on registered form and when it is held by an intermediary, they take on bearer form.

Finally, to be negotiated on a regulated market or on a multilateral trading facility, financial securities which must legally be in registered form must have been previously placed in an administration account and others, i.e. those which need not legally be in registered form, must take on bearer form.

AMF news

Ruling of 4 March 2009 approving modifications to the AMF General Regulations

Modifications made to chapter III of the AMF General Regulations relating to providers are as follows:

- Portfolio management companies and investment services providers which supply a portfolio management service on behalf of third parties have an extra 15 days to send their annual information sheet to AMF. This sheet must therefore be sent within four and a half months of the end of the financial year (Article 313-53-1);
- Subscription and buyback commissions received by a management company at the time of subscription or buyback of shares from its own stock, either by itself or by a company linked to it, are forbidden. However, this ban no longer applies if the subscription or buyback is carried out for a managed portfolio (Article 314-85) ;
- When, in accordance with its voting policy, the portfolio management company has not exercised has not exercised any voting right during the corporate financial year, it is no longer obliged to produce the report in which it sets out the conditions in which it has exercised its

voting rights. But it must then ensure that its voting policy is accessible to shareholders and clients at its site (Article 314-101).

The modifications made to chapter IV of the AMF General Regulations in relation to collective savings products mainly involve OPCIs and contractual UCITSs. When these are formed they must send the AMF confirmation of the funds deposited, immediately after depositing the funds or at the latest within 60 days.

AMF holds consultation regarding its planned instructions in relation to licensed and simplified FCPR prospectuses

These instructions are intended to replace those of 6 June 2000, remembering that licensing and declaration procedures for FCPRs will be addressed in two other instructions. These, which were the subject of consultation last December, have not yet been published.

European news

The European Commission organized a high-level conference on alternative funds and private equity funds on 26 and 27 February 2009.
During the conference, AMF chairman Jean-Pierre Jouyet declared in relation to private equity: "*We have to levers available: (1) to adopt ratios restricting corporate debt; (2) to adopt a single European vehicle to multiply the ways of financing SMEs, which are creators of jobs in the European area. Despite the risks of decentralized purchasing inherent in the establishment of a European structure on an integrated market, I believe that what we now need to do above all is reduce the risk of smothering our companies. It is therefore in our interest to expand the funding base by putting an end to this patchwork of incongruous regulatory frameworks*."

Over the course of the coming month, proposals for European laws may be devised aiming to provide a better framework for these two types of vehicles and activities.

Tax news

Publication of ruling no 2009/05 (FP) on the system for progressive exoneration of capital gains realized by directors when they sell shares in their company in order to retire

The tax authorities concede that in the case of sales of company shares carried out, firstly, by a co-founding director who meets all the conditions set out in article 150-0 D ter of the CGI (French General Tax Code) excluding the condition relating to ownership of a substantial proportion of the company involved, and, secondly, by one or more cofounders of the company, the gains achieved jointly by all selling cofounders may be reduced under certain conditions

Application of the system to combat underfunding set out in article 212 of the CGI in the case of a foreign share capital company which is taxable in France on property income in the absence of a permanent establishment.

In ruling no 2009/04 (FE), the tax authorities set out the conditions for applying article 212 of the CGI to foreign share capital companies which are taxable in France on property income although they have no permanent establishment there

Recent taxation instructions

- 4 B-3-09 n° 30 of 20 March 2009: Exoneration of capital gains realized at time of retirement – Amendment to the terms set out in article 151 septies A of the CGI - Articles 11 of the 2009 Finance Act, 38 of the amended 2008 Finance Act and 2 of the amended 2009 Finance Act.

- 14 A-1-09 n° 26 of 11 March 2009: List of taxation conventions agreed by France in force on 1 January 2009.

- 4 B-2-09 n° 21 of 24 February 2009: Capital gains and losses (Industrial and commercial profits, corporate income tax, Common provisions). Tax regime for long-term capital gains and losses. Transfer of patents and related elements by companies subject to corporation tax. Eligibility for the long-term capital gains regime set out in article 14 of the 2008 Finance Act

Recent Legal Advice and Key Deals – Upcoming conferences

Recent Legal Advice and Key Deals:

- Wealth tax holding companies: constitution, information notices and marketing procedures

- Challenging SCR adjustment to the minimum business tax contribution

- Negotiating platforms

- Public offering

- Defaulting LP negotiation

- Investments freeze negotiation

- Consultation on the difference between holding company-active holding company–operating company with shares in subsidiaries under the TEPA system

- Licensing of wealth tax FCPIs/FIPs

- Fiscal advice relating to bonus allocations to foreign residents
- Challenge relating to early repayment of R&D tax credit
- Ratio audit of simplified FCPRs

Upcoming conferences:

Private Equity

- **Annual private equity conference**, on the themes of "Private Equity investment in a new environment - Private Equity: new opportunities of the crisis – Industry best practice – Managing your portfolio in 2009", 7 April 2009 from 8am to 6.30pm, being held at the Palais Brongniart in Paris, with Me Daniel Schmidt as speaker, organized by the AFIC. Proskauer Rose is sponsor of this event.
- **IIR Mezzanine conference** at the Plaza Athénée in Boston on 29 April 2009 - Organized by IIR with support from the Private Equity team.
- **Tax & Legal Committee** – Organized by the EVCA in Proskauer Rose's premises on 12 May 2009, with Me Daniel Schmidt as speaker.

Labor Law

- **HR Club**: Employment law case law review – organized in partnership with the AEF in Proskauer Rose's premises on 9 April 2009 with Béatrice Pola as speaker.
- **Training: Certificate in Psychosocial Risk Management** - organized in partnership with the ESC Dijon in Proskauer Rose's premises on 22 and 30 April and 11, 12 and 13 May 2009, with Béatrice Pola as speaker.
- **HR Club**: Termination procedures: contractual termination, resignation, dismissal, formal acceptance, cancellation, transaction) – organized in partnership with the AEF in Proskauer Rose's premises on 14 May 2009 with Béatrice Pola as speaker.
- **"Latest developments in the concept of equal treatment"** training – at the Maison du Barreau in Paris on 25 May 2009, with Me Yasmine Tarasewicz as speaker.

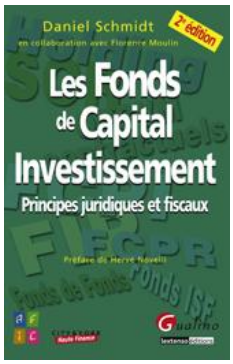
Disputes

- **"Faute Inexcusable" conference**, on 2 April, with Me Valérie Lafarge-Sarkozy and Me Philippe Goossens as speakers, organized by the EFE.

- **"Procédure Pénale" conference** – Organized by Dii at their premises on 20 May 2009 with Philippe Goossens and Eric Deprez as speakers.

Upcoming publications:

- ***Les Fonds de Capital Investissement, Principes Juridiques and Fiscaux*****,** *2nd edition,* Daniel Schmidt and Florence Moulin (Proskauer Rose), Preface by Hervé Novelli, published by Gualino Editeur (on sale from AFIC and others).



- ***Le Guide des négociations commerciales 2009-2010,*** Mireille Dany (Proskauer Rose), Régis Fabre and Léna Sersiron (Baker & McKenzie), on sale from 22 April from Éditions Dalloz

- ***Guide de l'investissement ISF dans les PME,*** published soon, with the collaboration of Daniel Schmidt and Florence Moulin (Proskauer Rose).

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Corporate / Private Equity / Financing

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