

Opinion Leaders

September 2010

Editorial - by Stéphanie Martinier

Audit committees in listed companies: AMF reports for duty

The order of December 8, 2008 (codified in articles L. 823-19 et seq. of the French Commercial Code) transposing directive 2006/43/EC of May 17, 2006, imposed the establishment of an audit committee in companies listed on a regulated market, enshrining in law a practice already widely accepted in the companies involved. Nevertheless, the wide array of terms in use raised numerous questions from practitioners and led the AMF to look into the interpretation of the text. On June 14, 2010 the AMF published its report into the audit committees instituted by the order of December 8, 2008. The report provides practical advice to companies involved regarding the establishment of audit committees and offers necessary and sought-after clarifications about the role and composition of these committees, as well as their members' responsibilities.

The order of December 8, 2008 stipulates that the composition of audit committees is determined by the Board of Directors or the Supervisory Board, which appoints those who will make up the committee from among its members. The Board itself sets the number of committee members, the AMF recommending a minimum of three. Members of the Board of Directors and the Supervisory Board occupying "*management functions*" are excluded from the audit committee in accordance with article L. 823-19 par. 2 of the French Commercial Code. The AMF declares in its report that it is in favour of an extensive interpretation of the notion of "*management functions*" which, it believes, applies equally to corporate officers and members of the company's general management team, such as the administrative and financial director. Finally, the 2008 order adds that one of the committee's members must "*present particular financial or accounting skills and be independent in relation to precise criteria*" published in the company's reference document or in the chairman of the board's governance report. This legal competency obligation with regard to a single committee member is not consistent with the importance of the audit committee's role.

The AMF therefore recommends that as well as the "*expert*" member, all audit committee members should have "*minimal competencies*" in the financial field and in relation to accounting for listed companies. The French market watchdog recommends that it is up to the Board alone to determine the criteria for required skills. As for the independence of audit committee members, this meets the same criteria as those applicable to members of the Board of Directors or the Supervisory Board and constitutes a vital prerequisite to the exercise of effective management control by committees.

However, this requirement for independence is limited to only one of the committee's members, which is not compatible with usual recommendations in this field and particularly with the recommendation contained in the AFEP-MEDEF code concerning corporate governance of listed companies, referred to by the AMF, which argues for two-thirds of audit committee members to meet the independence criteria in place in the company. By way of comparison, in the United States the Sarbanes Oxley Act, which has imposed the existence of an audit committee on companies listed on the US market, stipulates that all members of the audit committee must meet the independence criteria contained in the law.

A detailed examination of the audit committee's various tasks shows that members' independence plays a key role in achieving them. In effect, the audit committee is responsible for monitoring questions relating to the development and control of accounting and financial information. It prepares the Board's work in the context of ruling off of the annual accounts and examining half-yearly accounts and may make any number of recommendations in this area. It must also ensure the company's compliance with principles of good governance since it is responsible for controlling the effectiveness of internal control and risk management systems. According to the AMF, the extensive role granted to the audit committee is a vital part of the proper analysis of the accounting and financial information submitted to it, since some facts and risks revealed by the system of internal control can have an effect on the accounts. The audit committee carries out its work with the support of the company's statutory auditors, who are obliged to inform it of any risks, irregularities and errors revealed in the annual or consolidated accounts or by examining them. The audit committee's role may go beyond the missions conferred on it by law since, according to the AMF, the list of the audit committee's missions set out in article L. 823-19 of the French Commercial Code is non-exhaustive and the Board may entrust it with "*any other mission it deems relevant*".

The existence of these various skills raises the issue of members' liability. In article L. 823-19, the French Commercial Code stipulates that members of the audit committee act "*under the exclusive and collective liability*" of the Board of Directors or the Supervisory Board. According to the AMF, the term "*exclusive*" means that audit committee members are only liable for their actions in their capacity as Board members. Meanwhile, according to the French market watchdog the term "*collective liability*" means that the Board members are liable as a whole. Board members do however retain the possibility of exonerating themselves from their liability under common law, by demonstrating that they have behaved prudently and diligently. This collective liability is the result of audit committees' lack of autonomy, since they owe their existence entirely to the Board of Directors and the Supervisory Board.

While the imposition of audit committees by the order of December 8, 2008 did not fundamentally change a practice already in place within listed companies, the AMF's precisions are likely to lead to a standardization of the practice and in due course strengthen corporate governance, particularly by reinforcing the role played by audit committees.

It should be noted that another committee with a sensitive role, the remuneration committee, may soon become legally enshrined in legislation. During debate of the draft bill on directors' remuneration on October 20, 2009, all articles apart from the one imposing a remunerations committee in companies listed on a regulated market were rejected by the National Assembly.

The issue of creating a framework for remuneration of corporate officers is certainly controversial. It is therefore no surprise that this draft proposal for a remunerations committee has still not been debated by the Senate. However, the recent adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act by US President Barack Obama^[1], strengthening legislation applicable to remuneration committees in companies listed on the American market and stipulating the independence of all members of this committee, suggests a strong movement towards regulation of the operating mechanisms of this other key committee.

Legal News

Framework for fees received by ISF vehicles (holding companies and Investment Funds).

Following a proposal by Senator Arthuis, the 2010 Finance Act adopted last winter stipulates that investors in ISF vehicles - holding companies and Funds - must be "*informed annually of the detailed amount of fees and commissions they pay*" and that a framework for "*remuneration conditions of operators marketing*" these vehicles should be established.

The procedures for providing this information and establishing this framework are to be set out via decree. A draft decree has been submitted for public consultation by the Financial Market High Commission (*Haut Comité de Place*).

This bill goes far beyond the text of the law. It does not content itself with simply setting out a framework for marketing costs, as stipulated. It caps all fees, including management fees. In order to render this mechanism legal, the draft 2011 Finance Act should provide a framework of all of the fees including the management fees received by the wealth tax and income tax vehicles

It also aims to increase investor information. This information will be a lot more detailed, provided before and after the investment is made, and must appear on all the documentation provided to the client (including the registration form on which they agree to the deduction of these fees).

Apart from genuinely in-depth questions regarding its effectiveness and proportionality in relation to the desired objective, this bill raises serious problems of interpretation.

The decree should be published at the latest during the first two weeks of October 2010.

You will find attached our latest contribution relating to the consultation regarding the draft bill.

IGF: the report's conclusion...

The French General Finance Inspectorate (Inspection Générale des Finances – IGF) was commissioned by Christine Lagarde to study the effectiveness of tax mechanisms encouraging individuals to invest in SMEs (via reductions in income tax or wealth tax).

After extensive investigations, the IGF has completed its report. Although this has not been made public, some of its conclusions have been reported in the press.

According to these stories, the report criticizes the level of distribution fees charged by FCPIs and FIPs. Their share has increased to a third of the amount deducted from savers.

The IGF also condemns the measure adopted a year ago aiming to reduce the timescales allotted to FCPIs and FIPs to invest the funds they raise. The 16-month deadline is judged to be incompatible with the necessary time required for professional selection of investments in non-listed companies.

The report apparently concludes that FCPIs and FIPs should be maintained and that wealth tax should be deducted in return for changes.

Heightened regulation of intermediaries in the marketing of financial products

Although the AMF has raised the possibility in the context of the UCITS IV directive of simplifying and harmonizing the various statuses allowing marketing of financial instruments, the government may anticipate the reform.

The financial regulation bill, due to be debated in the Senate in the coming days, plans to register intermediaries (financial advisors, insurance brokers, etc.) on a single register held by Orias and make them subject to standardized rules of conduct.

Furthermore, the bill is also due to prohibit credit institutions and investment companies from outsourcing to simple salespeople the job of contacting investors and offering to supply them with investment services. These salespeople must now have financial advisor or a tied agent.

Finally, the government is apparently hostile to the proposal by Louis Giscard d'Estaing to create a status of asset management advisor (Conseil en Gestion de Patrimoine - CGP), since this is theoretically already regulated under the status of financial advisor (Conseiller en Investissements Financiers - CIF).

Financial services: latest measures from the European Commission

This summer the European Commission adopted legislation stipulating the conditions for application of the UCITS IV directive, which will come into force on July 1, 2011.

Two directives and two regulations now set out:

key investor information – a new standardized and harmonized disclosure document has been established, designed to enable investors to make effective investment decisions. An application regulation governs the document's content and format, particularly stipulating the use of clear language and a much more comprehensible presentation of information regarding investor risk. The application regulation includes precise methods for calculating the level of a fund's risk and the fees due.

the rules concerning the operation of UCITS management companies – an application directive makes the organizational requirements and rules of conduct applicable to investment companies consistent with standards already applicable to most financial services under the MiFID directive. These rules also cover prevention, management and the notification of conflicts of interest. The directive also requires UCITS managers to use sufficiently reliable and effective procedures and techniques to properly manage the various types of risk to which UCITS are exposed.

The framework for mergers of UCITS and master/feeder structures – an application directive sets out certain measures protecting investors in relation to these asset grouping techniques and establishes a joint approach to sharing information between master funds and feeder funds. It also includes detailed rules relating to liquidation, merger and splitting of a master UCITS.

the notification and cooperation procedure in relation to supervision – an application rule defines the standard documents and procedures to use for electronic transmission in the context of the notification procedure (used by a UCITS when it wants to access a market in another member state). It also sets out common procedures for strengthening cooperation in terms of supervision and fund managers' cross-border activities.

USA: most fund managers and advisors located outside the USA are now obliged to be registered with the SEC

Non-American fund managers who:

have US investors in their funds,

manage funds based in the US,

are present in the US,

advertise in the US,

are all covered by the new regulations, adopted on July 21, 2010 and coming into force on July 21, 2011.

This involves alternative fund managers and advisors (capital investment, infrastructure, real-estate, hedge funds, funds of funds, etc.), whether they have an advisory or management capacity (whether discretionary or not).

They need to register with the SEC by July 21, 2011 at the latest. Failing this, their civil and even criminal liability may be incurred.

Exceptions are possible however. For instance, managers and advisors who do not have offices in the US, have a total of fewer than 15 American clients or investors and manage less than US\$25m from these investors are due to be exempt, under certain conditions, from the compulsory registration. Family offices and advisors who act for them solely as advisors for one or more venture capital funds are also due to be exempted.

Tax news

Decree no. 2010-915 of August 3, 2010 relating to wealth tax exemption set out in article 885 I ter of the French General Tax Code

This decree, codified in article 299 bis of annex III of the French General Tax Code, sets the notification obligations on taxpayers who want to benefit from wealth tax exemption allowed for under article 885 I ter, i.e. due to shares they own in wealth tax holding companies or shares they own in FCPRs, FCPIs or FIPs.

2010 Finance Bill

The bill is due to be unveiled on September 29, at the last meeting of the Council of Ministers in September. As announced, one of the objectives is to reduce the fiscal cost of loopholes in tax and social charges, whether they benefit individuals subject to income tax or companies subject to corporation tax.

Income tax loopholes to be reviewed include taxation on life insurance.

All life insurance policies will now be subject to social contributions. Also so-called multi supports funds will no longer be subject to social contributions at the time of surrender but each year, in the same way as guaranteed income policies.

Another tax loophole relates to FCPIs and FIPs. Although it had been announced that FCPIs and FIPs would cease at the end of 2010, the government is due to continue the system in some shape or form. The changes may affect:

- the investment policy, focusing it more on small and medium sized companies and excluding certain investment sectors,

- the tax benefits: their cap or their level of income tax reduction (currently amounting to 25%) being reduced,

- the capping of all of the fees (including the management fees) would be voted and extended to wealth tax reduction vehicles (FCPI, FIP and holding companies),

- the reduction of the investment deadlines recently adopted could be questioned,

- the income tax advantage could, as in terms of the wealth tax, be calculated by transparency, that is, the income tax reduction (currently amounting to 25%) would not be calculated based on the amount of the subscription but on the percentage that the fund has committed to invest in eligible companies,

- the level of wealth tax reduction, which varies from 50% for Funds to 75% for direct or intermediate holding companies will be aligned and changed to 50% or 60% across the board.

Furthermore, the tax or social regime applicable to capital gains on securities currently taxed at 30.1% (including 12.1% of social charges) may be reviewed. Several possible options are possible: a reduction in the tax threshold (€25,730), increase in taxation rates, and removal of the allowance per year of ownership.

Companies subject to corporation tax may meanwhile see dividends under the parent/subsidiary regime, along with long-term value-added on stakes of more than 5% held for more than two years, taxed on the full amount, and no longer the 5% proportion for fees and charges. In terms of funds, the deductibility of loan interest for the purchase of shares, which benefits LBO transactions, may be considerably reduced.

Update on 2010 wealth tax collection

One measure contained in the "tax section" of the TEPA Act is turning into a runaway success – the reduction in wealth tax for investments in SMEs. More than 140,000 taxpayers have so far benefited from the measure in 2010, representing an increase of nearly 50% compared with 2009.

Recent taxation instructions

??5 B-19-10 no. 75 of August 9, 2010: Income tax. Overall cap on certain income tax benefits.

??4 A-7-10 no. 73 of August 5, 2010: Various provisions (Industrial and commercial profits, corporation tax, common provisions, taxable basis, allowances and deductions benefiting certain companies) – Exemption on profits made by companies based in R&D areas of competitiveness clusters (article 59 of the Amended 2009 Finance Act no. 2009-1674 of December 30, 2009).

??13 L-7-10 no. 73 of August 5, 2010: Prevention of use of the financial system for the purposes of money laundering and terrorist funding – Implementation of the obligation to notify set out in paragraph II of article L. 561-15 of the French Monetary and Financial Code – List of states or countries which have agreed an administrative assistance convention with France to combat fraud and tax evasion, enabling access to banking information for application of article D. 561-32-1 of the French Monetary and Financial Code.

??4 C-5-10 no. 71 of August 2, 2010: Fees and charges (Industrial and commercial profits, corporation tax) – Interest on third-party equity. Conditions and limits for deduction of interest on advances granted by shareholders over and above their shareholding. Maximum rates of interest deductible for tax purposes.

Upcoming Conferences

??21 september 2010 – **Les Rendez-vous Lamy de l'Actualité** on "**Risques Psychosociaux : Stress, harcèlement moral, suicide : comment les prévenir et la responsabilité de l'employeur**". Speakers include: **Yasmine Tarasewicz**, Partner, Proskauer. Hôtel Intercontinental Paris, 9 am to 5 pm.

??23 september 2010 – **Labor and Employment monthly breakfast seminar "Club RH"** on "**Rupture conventionnelle, prise d'acte, résiliation judiciaires : enjeux et risques des nouveaux modes de rupture concurrents de la démission**" - in partnership with the press agency AEF. Speaker: **Béatrice Pola**, Partner, Proskauer. In Proskauer's Paris office, 8:30 am -10:30 am.

??28 september 2010 - **Litigation Breakfast Seminar** on "**La Faute de Gestion**".

Speakers **Valérie Lafarge-Sarkozy**, Partner and **Virginie Reynés**, Associate, Proskauer. In Proskauer's Paris office, 8:30 am -10:30 am.

??30 september 2010 - **M&A and Private Equity Breakfast Seminar** on "**Les**

Pactes d'Actionnaires". Speakers: **Guillaume Kellner**, Head of our Corporate practice and **Etienne Mathey**, Associate, Proskauer. In Proskauer's Paris office, 8:30 am -10:30 am.

??7 October 2010 - **Tax provisions of the 2010 Finance Bill regarding SMEs** -

Organized by the Association PME Finance. Speakers : **Daniel Schmidt**, Partners and **Florence Moulin**, Associate, Proskauer. At the Senate, 8.30 am - 12.30 pm.

“Opinion Leaders” is also available on our Internet site, in the News and Publications section under Newsletters: www.proskauer.com

[1] Law passed July 21, 2010