

**AMF position-recommendation**  
**Guide for retail and professional private equity funds – DOC-2012-11**

Reference documents: Articles L. 214-24-45, L. 214-27, R. 214-40, R. 214-41, R. 214-53, R. 214-54, R. 214-71, R. 214-72, R. 214-204 and R. 214-205 of the Monetary and Financial Code

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**Unless explicitly identified as recommendations, the policies described in the present document are positions.**

**For authorised retail private equity funds that still have offer documents, references to the Key Investor Information Document (KIID) in the present position-recommendation should be taken as references to the offer document.**

## 1. Maturity management and liquidation procedures for retail private equity funds

This first part of the present document aims to answer the main questions raised by market professionals on managing the maturity of private equity funds (retail private equity funds, retail venture capital funds and retail local investment funds) and to describe liquidation procedures for private equity funds between the opening of the pre-liquidation period and liquidation itself.

The liquidation process for these private equity funds is determined by a number of regulations. In 2003 they were complemented by the introduction of a new stage in the fund liquidation process known as pre-liquidation.

The AMF hopes to answer questions relating to these procedures in this policy document and to provide an exhaustive description of the various stages in the fund liquidation process.

The term ‘fund’ refers here to all retail private equity funds, retail venture capital funds and retail local investment funds. This document does not deal with the tax treatment of the fund liquidation process.

### 1.1. Maturity management

Some practices involve the extension of the lockup period for invested sums well beyond the 8-10 years generally provided for among private equity funds. This does not appear to comply with the regulations.

#### 1.1.1. Lockup period for sums invested in private equity funds

The lifespan of private equity funds is specified in their rulebooks<sup>1</sup>. By definition, sums invested have to be returned to unit holders at the end of this term at the latest. It follows that the liquidation of all the assets owned by the fund has to be completed by that time, and it is for the management company to manage the fund’s portfolio in a way that meets this requirement. This implies, among other things, that the divestment process for unlisted assets has to have been started early enough to be completed before the end of the life of the fund concerned.

The law states that at the end of the 10-year lockup period, “unit holders can demand the liquidation of the fund if their requests for repayment have not been met within a year<sup>2</sup>”. This provision should not be interpreted as an authorisation for funds to delay liquidation to beyond the lifespan stated in their rulebooks. It should be regarded instead as an additional element of investor protection that ensures management companies limit the lifespan of private equity funds to 10 years.

#### 1.1.2. Clarification on implementation

For funds being created or being marketed, the AMF points out that the requirement for fair, clear and not misleading information<sup>3</sup> implies that:

- the fund rulebook states the fund’s lifespan and the terms on which payouts of the receipts from asset sales are made, with regard (where relevant) to the provisions applicable to the pre-liquidation period;
- the fund rulebook states how the management company envisages dealing with the end of this lifespan:
  - o estimated maximum length of the investment phase;
  - o estimated date of the start of liquidation;
  - o the date on which the portfolio’s liquidation will be completed;
- marketing materials are consistent with the information in the KIID and the fund prospectus. This implies, among other things, that they refrain from highlighting the lockup period associated with the

<sup>1</sup> Annex VII of Instruction 2011-22

<sup>2</sup> Article L. 214-28 of the Monetary and Financial Code

<sup>3</sup> Article L. 533-12-1 of the Monetary and Financial Code

tax advantage (5 years) when the fund's lifespan is longer than this period, and that they explicitly state the expected lockup period for invested sums.

For existing funds:

- the management company should make or have made provision, as the case may be, for the orderly liquidation of the fund portfolio before the end of the fund's life.
- in the contrary case, the management company is liable when it does not act in the interests of unit holders, for example if it extends the liquidation period beyond the end of the fund's life as stated in the fund rulebook.
- in principle, the fund's lifespan is stated in its rulebook. Even so, the management company must check that the other documents used to market the fund (KIID, prospectus, marketing materials) do not suggest a shorter term. If there is no mention of the fund's lifespan in these various documents, a letter must be sent to each unit holder to remind them that they have the right to request the redemption of their units at the end of 10 years, and that if they are not repaid after one year they can demand the fund's liquidation. Article L. 214-28 of the Monetary and Financial Code is applicable as soon as a unit holder requests the redemption of units.

The management company must have made provision for maintaining its obligations under these provisions.

- management companies should exercise particular vigilance if, in the context of liquidation, they seek to transfer unlisted assets to other investment vehicles that they manage or that are managed by another entity in their group. The AMF points out that the management company must be able to demonstrate that this sale is in the interest of both the selling and the purchasing entities, and that it is executed at an appropriate price even though such transactions would or may not be likely to be effected on the market, given the difficulty of determining a market price for these assets in these circumstances.

#### **Recommendation**

**For professional private equity funds, it is usual practice for management fees to be reduced sharply once the portfolio liquidation process has started.**

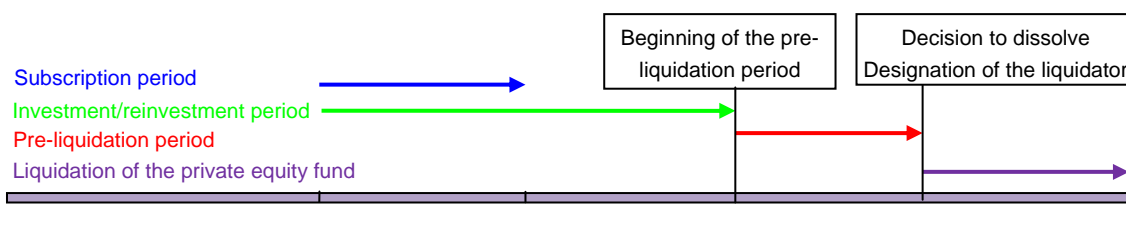
**The AMF recommends that management companies extend this practice to all private equity funds.**

### **1.2. The stages in the liquidation of a private equity fund**

There are three stages in the liquidation of a private equity fund:

- **the first stage** corresponds to the pre-liquidation period and is optional. It consists of preparing for the sale of portfolio assets, taking account of their nature and characteristics, while respecting the maturity of existing investments.
- **the second stage** is the decision to dissolve the fund, i.e. deciding to terminate its existence. This decision leads to the third stage.
- **the third stage** is liquidation, which covers the realisation of portfolio assets and the repayment of unit holders.

### Fund liquidation flowchart



## 1.3. The pre-liquidation period for private equity funds

### 1.3.1. What is pre-liquidation?

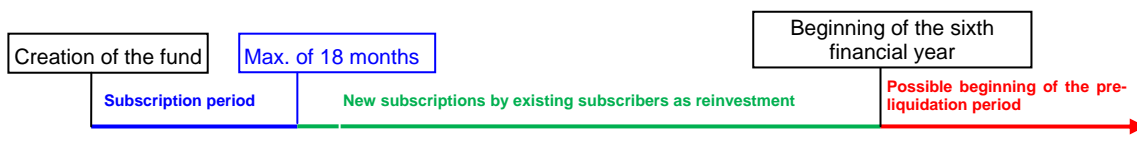
The pre-liquidation period is regulated by Articles R. 214-40 and R. 214-41 of the Monetary and Financial Code for retail private equity funds, Articles R. 214-53 and R. 214-54 of the Monetary and Financial Code for retail venture capital funds and Articles R. 214-71 and R. 214-72 for retail local investment funds.

Pre-liquidation is the period in which the management company prepares for the fund's liquidation, thereby reducing the time it takes for liquidation itself. During this period the management rules and asset sale procedures are exempt from general law on private equity funds.

### 1.3.2. When can there be a pre-liquidation period?

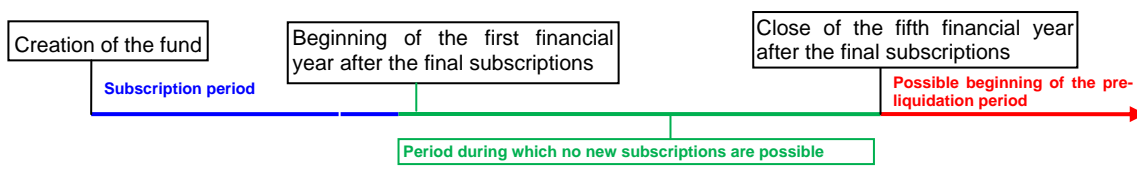
Article R. 214-40 of the Monetary and Financial Code describes two situations in which pre-liquidation can take place.

- **First case: Article R. 214-40 para. 1.** The fund can enter a pre-liquidation phase no earlier than the beginning of the financial year following the close of its fifth financial year, and even then on condition that at the end of the 18 months following its creation, new subscriptions have not been made only by existing subscribers and exclusively as reinvestment<sup>4</sup>. The flowchart below summarises the terms on which pre-liquidation can take place under these provisions.



- **Second case: Article R. 214-40 para. 2.** The fund can enter a pre-liquidation phase from the beginning of the financial year following the close of the fifth financial year after the financial year in which its final subscriptions were paid. The flowchart below summarises the terms on which pre-liquidation can take place under these provisions.

<sup>4</sup> These conditions are defined in clauses (a) and (b) of Article R. 214-40 §1 of the Monetary and Financial Code. The new subscriptions must be for the purpose of enabling the fund "a) to reinvest in units, shares, bonds, convertible bonds or profit-sharing securities as well as a current-account advance to companies not admitted for trading on a market for financial instruments within the meaning of §1 of Article L. 214-36 or entities described in § (b) of Article L. 214-36 whose securities or rights appear in their balance sheet" or "b) to meet a reinvestment obligation as described provided for under Article 163 B (d) of the General Tax Code."



## Maturity

1.3.3. Can a fund have a pre-liquidation period if it has not provided for pre-liquidation in its rulebook?

Yes. The decision to open a pre-liquidation period is a matter for the fund's management company.

1.3.4. What has to be notified to the AMF in relation to a pre-liquidation period?

A management company seeking to open a pre-liquidation period for a fund it manages must declare its decision to the AMF beforehand.

The declaration file must comprise the following:

- a letter describing the reason for the pre-liquidation period,
- a draft of the information document that the management company intends to send to unit holders, and before any unit holder has received it.

1.3.5. How are unit holders to be informed of the start of a pre-liquidation period?

Following prior declaration to the AMF, and at least three business days before the pre-liquidation period is to start, the management company should send each unit holder information documentation or a letter describing the start of this period and the possible consequences for the fund's management.

See also Instructions 2011-22 relating to authorisation processes, and the production of the KIID, rulebook and periodic information for private equity funds.

1.3.6. What exemptions to management rules apply to the pre-liquidation period?

As soon as the pre-liquidation period starts, the fund is no longer required to respect the investment quota for unlisted securities specified in part I of Article L. 214-28 of the Monetary and Financial Code for retail private equity funds, part I of Article L. 214-30 for retail venture capital funds and part I of Article L. 214-31 for retail local investment funds.

1.3.7. How does the fund operate during the pre-liquidation period?

During the pre-liquidation period the fund is subject to specific operating rules aimed at easing the liquidation of portfolio assets by the management company.

These operating rules are as follows.

1) In accordance with Article R. 214-41 §1 of the Monetary and Financial Code for retail private equity funds, Article R. 214-54 §1 for retail venture capital funds and Article R. 214- 72 §1 for retail local investment funds, the fund cannot accept new subscriptions for units other than from existing unit holders for reinvestment purposes.

2) In accordance with Article R. 214-41 §2 of the Monetary and Financial Code for retail private equity funds, Article R. 214-54 §2 for retail venture capital funds and Article R. 214- 72 §2 for retail local investment funds, the fund can sell an entity related to its management company by derogation from Article R. 214-43, R. 214-56 or R. 214-74 of the Monetary and Financial Code, or equity securities or debt securities it has held for more than 12 months. Such divestments must be assessed by an independent

expert with a report made to the fund's auditors. The management company must inform the AMF of any divestments and of the related reports.

3) In accordance with the provisions of Article R. 214-41 §3 of the Monetary and Financial Code for retail private equity funds, Article R. 214-54 §3 for retail venture capital funds and Article R. 214- 72 §3 for retail local investment funds, the fund's holdings during the financial year following the start of the pre-liquidation period are limited to:

- unlisted securities;
- listed securities, it being understood that such securities are included in the 50% ratio specified in Articles L. 214-28 and R. 214-35 of the Monetary and Financial Code for retail private equity funds, in the 60% ratio specified in Articles L. 214-30 and R. 214-47 of the Monetary and Financial Code for retail venture capital funds and in the 60% ratio specified in the Articles L. 214-31 and R. 214-65 of the Monetary and Financial Code for retail local investment funds;
- current-account advances to these same companies;
- rights representing financial investments in an OECD member state whose main purpose is investing in unlisted companies; and
- investments of receipts from the sale of these assets and other products being distributed no later than the close of the financial year following that in which the sales were executed or receipts were received, and the investment of cash amounting up to 20% of the fund's net asset value.

#### **1.4. Dissolving a private equity fund**

##### 1.4.1. What is dissolution?

Dissolution is the decision to end the fund's existence. The management company can reach this decision either in the course of its management operations or because of the materialisation of one of the events triggering mandatory early dissolution described below.

Following such a decision, the fund is liquidated.

##### 1.4.2. What are the early dissolution events?

There are two types of early dissolution: one is applicable to all investment funds and one exclusively to private equity funds.

1) The early dissolution events applicable to all investment funds are as follows:

- in accordance with Article 422-22 of the AMF General Regulation, early dissolution is triggered if the fund's outstandings are below 300,000 euros for at least 30 days;
- with regard to the provisions of the first section of Article 422-120 of the AMF General Regulation, the liquidation of a master fund can trigger the liquidation of a feeder fund;
- a redemption request for all fund units by unit holders.

2) Article L. 214-28 VII of the Monetary and Financial Code provides for early dissolution in the specific case of private equity funds when, after a 10-year period, unit holders exercise their right to demand the liquidation of the fund when their reimbursement requests have not been met within 12 months.

##### 1.4.3. Does dissolution require AMF authorisation?

Yes. AMF authorisation is required for the dissolution of private equity funds.

Except in the case of the redemption of all fund units, such authorisation has to be obtained beforehand. This requires the submission of an authorisation request to the AMF. With regard to the applicable rules and prevailing practice, the authorisation request should include the following documentation:

- three copies of the specific and duly completed and signed authorisation certificate;
- the management company's dissolution decision;
- the name and contact details of the person designated as liquidator, if this is not the management company;
- the draft information letter intended for circulation to each individual unit holder;
- the most up-to-date fund rulebook;
- the most up-to-date information memo or KIID;
- the fund's most recent portfolio statement.

The AMF has eight business days from the date it registers the authorisation request in which to notify the management company of its decision (Article 422-120-6 of the AMF General Regulation).

#### 1.4.4. How are fund units redeemed?

In principle, fund units are redeemed in cash (Article R. 214-44 II of the Monetary and Financial Code for retail private equity funds, Article R. 214-57 II for retail venture capital funds, Article R. 214-75 II for retail local investment funds).

That said, when the fund is dissolved its units can be redeemed in the securities of companies in which the fund has an ownership share, subject to the three following conditions:

- the fund's rulebook provides for it;
- the unit holder makes an express request for such redemption to the management company; and
- no provision or particular clause limits the free tradability of such securities.

#### 1.4.5. What is the main consequence of the fund's dissolution?

Dissolution triggers the start of liquidation, from which time no redemption is possible. The management company still reserves the possibility of distributing fund assets, however.

The fund's legal existence continues until the total liquidation of the assets in its portfolio.

### 1.5. Liquidating a private equity fund

#### 1.5.1. What is liquidation?

Liquidation is a series of transactions carried out by a liquidator, aimed at realising the value of the assets composing the portfolio and at reimbursing the fund's unit holders.

#### 1.5.2. Who liquidates the fund's assets?

Article L. 214-24-45 of the Monetary and Financial Code states that the fund's management company or depositary can act as liquidator.

In principle, the fund's management company assumes this role.

#### 1.5.3. How is liquidation carried out?

Several types of transaction are involved in liquidating the fund's portfolio:

- 1) the liquidator divests the fund's portfolio of shareholdings in unlisted companies;
- 2) as and when these transactions are completed, payouts are made to unit holders. Unit holders will have been informed beforehand of the liquidation and payout process. The terms of allocations and payouts are defined in the fund rulebook;



3) all unit holders are reimbursed, it being understood that carried interest unit holders as defined in Article R. 214-44 II §4 of the Monetary and Financial Code for retail private equity funds, Article R. 214-57 II §4 for retail venture capital funds and Article R. 214-75 II §4 for retail local investment funds obtain the redemption of their units only at the end of the fund's liquidation or after the other units have been redeemed or amortised to their paid-up amount.

1.5.4. What information has to be sent to the AMF at the end of the liquidation?

Once the liquidation is complete, the fund's auditors must provide a report on the liquidation process and on transactions executed at the end of the preceding financial year. This report is made available to unit holders and must be submitted to the AMF within a month of its completion.

1.5.5. Do funds in the process of liquidation still have to report their net asset values to the AMF?

Yes. The management company is still required to inform the AMF of the fund's net asset values via its secure access to the Geco database (collective investment undertakings and savings products), respecting the information-sharing procedure, and even when it is not receiving any more subscription or redemption requests.

1.5.6. Do funds in the process of liquidation still have to pay their AMF levies?

Yes. The fact that a fund is being liquidated does not exempt it from the AMF levy.

## **2. Professional private equity funds**

### **2.1. What due diligence is required for professional private equity funds that invest the entirety of their assets in a single entity established under foreign law?**

A professional private equity fund can invest the entirety of its assets in a sole and single entity established under foreign law only under all of the following conditions:

- It must be possible to market the underlying entity in France:
  - when it is a closed-end fund within the meaning of Directive 2003/71/EC, it has the passport provided for under this directive or could be marketed as a private placement;
  - if the underlying entity is classified as an alternative investment fund (AIF), it must not only respect the provisions of Directive 2003/71/EC, if applicable, but also have a passport under the terms of Directive 2011/61/EU for the marketing of its units or shares in France or a marketing authorisation in accordance with Articles 421-13 and 421-13-1 of the AMF General Regulation;
  - if the professional private equity fund and the underlying entity are classified as a master AIF and a feeder AIF, respectively, within the meaning of Article L. 214-24-57 of the Monetary and Financial Code, they must comply with the provisions of Article 422-105 of the AMF General Regulation. If the professional private equity fund and the underlying entity are classified as a feeder AIF and a master AIF, respectively, within the meaning of Directive 2011/61/EU, they have to comply with the provisions of Article L. 214-24-1 II of the Monetary and Financial Code.

These conditions ensure that the professional private equity fund does not invest in a fund that cannot be marketed in France, thereby bypassing the applicable marketing rules;

- The professional private equity fund's management company actually carries out management activities. This condition implies that the management company is able to arbitrage all or part of the fund's assets into one or several other underlying entities, for example. The professional private equity fund's rulebook must clearly indicate this possibility.
- The management company must ensure that the professional private equity fund is not structured with the aim of bypassing investment rules that prevent investors from investing directly in the underlying entity to the same degree.

**2.2. Is special and express agreement from unit holders required for a company managing a professional private equity fund to have the power to conclude liability guarantees on behalf of the fund?**

In accordance with section III of Article R. 214-205 of the Monetary and Financial Code, the management company can conclude agreements with third parties relating to the management of the professional private equity fund's assets and that include contractual commitments other than delivery, as well as agreements granting third parties rights to the fund's assets and the uncalled portion of subscriptions, including personal or property guarantees, subject to the conditions specified in the fund rulebook and the agreement of unit holders.

Acceptance of the professional private equity fund's rulebook at the point of subscription implies unit holders' agreement with these conventions when they are concluded in the conditions defined in the rulebook.

**2.3. Lockup period for professional private equity funds**

Article L. 214-160 III of the Monetary and Financial Code provides for an exemption to L. 214-28 VII of the Monetary and Financial Code applicable to private equity funds. It permits the professional private equity fund's rulebook to block the redemption of units at the unit holders' request for a period exceeding 10 years.

When a professional private equity fund is created, the management company must specify the lockup period for redemptions in the rulebook.

For existing funds, the extension of the lockup period beyond the term specified in the fund rulebook must be approved unanimously by unit holders and must be reported to the AMF.

**2.4. What is the dissolution and liquidation procedure for professional private equity funds?**

The dissolution and the end of the liquidation of professional private equity funds are subject to a declaration by post to the AMF. The declaration must be made in the month following the event. The management company must also input this information in the Geco database in compliance with the information-sharing procedures with the AMF.

As far as unit holders are concerned, professional private equity funds are subject to the same information obligations as retail private equity funds.

That said, certain exemptions from the regulations applicable to retail private equity funds determine the procedures for the dissolution and liquidation of professional private equity funds.

Upon dissolution, for example, units can be redeemed in securities in companies in which the fund has an ownership share, subject to the sole condition that the rulebook provides for this (Article R. 214-205 II §1 of the Monetary and Financial Code). Moreover, the rule that states that holders of carried interest units cannot obtain the redemption of these units until the end of the fund's liquidation or after the other units have been redeemed or amortised to the amount to which they have been paid up is not applicable to fast-track procedure retail private equity funds (Article R. 214-205 II §2 of the Monetary and Financial Code).