

Position – AMF Recommendation
Guide to the organisation of the risk management system within asset management companies – DOC-2014-06

References: Articles 313-1 to 313-7, 313-53-2 to 313-58, 313-60, 313-62 to 313-71, 318-4 to 318-6 and 318-38 to 318-56 of the AMF General Regulation
 Articles 38 to 49 of Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012

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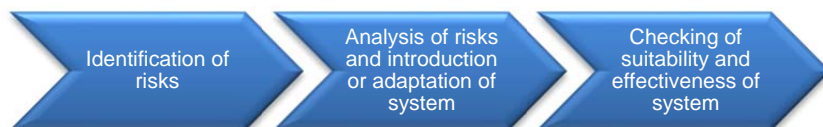
Object and scope

The positions and recommendations in this guide aim to clarify the expectations of the French Financial Markets Regulator (*Autorité des Marchés Financiers* - AMF) with regard to the organisation of the risk management system of asset management companies (AMCs). This guide is for AMCs that manage UCITS or AIFs and/or provide a discretionary portfolio management service.

In order to control the risks associated with their business, AMCs should introduce and maintain a risk prevention and management system, and regularly check it is being applied correctly.

In order to do this, AMCs should identify the risks they wish to guard against and therefore need to eliminate, and the investment risks to which they wish to be exposed and therefore need to manage. As such, the risk management system of an AMC involves:

- identifying the risks to which it is exposed;
- analysing these risks and introducing a tailored risk prevention and management system;
- checking the suitability and effectiveness of the system that has been implemented.



1. Identifying risks

The risks that AMCs must take into account during the risk mapping process are defined in regulations. The AMC can establish or adapt its risk management system by identifying existing and potential risks and determining an acceptable level of risk.

1.1. Financial risks



Financial risks, which include liquidity, market and counterparty risk, are defined in the AMF General Regulation and mentioned in the Commission Delegated Regulation (EU) No. 231/2013¹ of 19 December 2012.

Counterparty risk is defined as the risk of loss for the collective investment scheme or the individual portfolio from the fact that the counterparty to the transaction or to a contract may default on its obligations prior to the final settlement of the transaction's cash flow;

Liquidity risk is defined as the risk that a position in the portfolio cannot be sold, liquidated or closed out at limited cost in an adequately short time frame and that the ability of the UCITS or the AIF to comply at any time with issue and redemption requirements at the request of investors, or the ability of the AMC to liquidate positions in an individual portfolio in accordance with the contractual requirements of the portfolio management mandate, is thereby compromised;

Market risk is defined as the risk of loss for the collective investment scheme or the individual portfolio resulting from fluctuation in the market value of positions in the portfolio attributable to changes in market variables such as interest rates, foreign exchange rates, equity and commodity prices, or an issuer's creditworthiness.

1.2. The risk of non-compliance

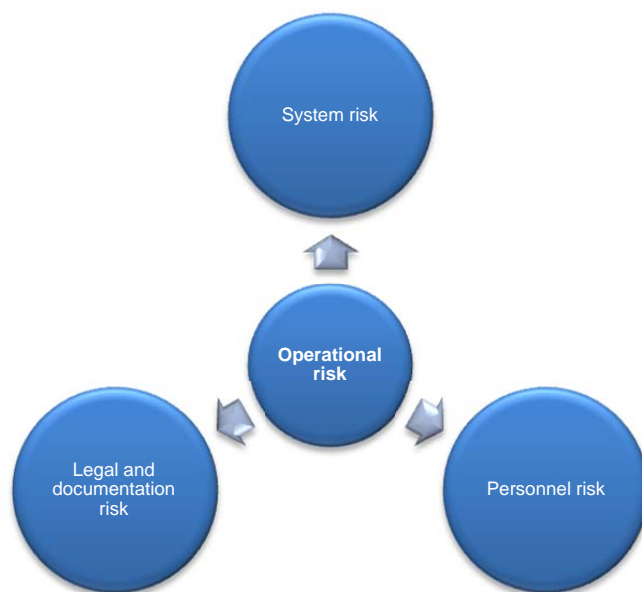


The risk of non-compliance is the risk that the AMC fails to comply with its professional obligations pursuant to Paragraph II of Article L. 621-15 of the French Monetary and Financial Code². As with any other risk, the risk of non-compliance should be assessed and managed in accordance with its potential consequences. If the AMC fails to comply with its professional obligations, it is likely to incur a cost in the form of its civil or criminal liability being invoked, an administrative penalty or damage to its reputation.

¹ See Articles 313-53-3 of the AMF General Regulation or 40-2 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012

² The professional obligations of AMCs include all those defined by laws, decrees, European regulations, the AMF General Regulation and the professional rules approved by the AMF.

1.3. Operational risk



Operational risk³ means the risk of loss for the collective investment scheme or the individual portfolio resulting from inadequate internal processes and failures in relation to people or systems of the AMC or from external events, and includes legal and documentation risk and risk resulting from the trading, settlement and valuation procedures operated on behalf of the collective investment scheme or the individual portfolio.

1.4. Risk mapping

Once the risks to which the AMC is exposed have been identified and limits have been set, risk mapping assesses the company's level of exposure to these risks, compares it with the pre-established limits and implements all the procedures necessary to manage the identified risks.

The AMC can establish quantitative or qualitative risk limits, or both, by taking into account all the relevant risks, including market risk, credit risk, liquidity risk, counterparty risk and operational risk.

Position

AMCs should periodically assess the risk levels to which the collective investment schemes and managed portfolios are exposed. Risk mapping should take into account all corporate processes linked to the individual or collective investment management business, and determine whether or not a risk factor is critical by measuring the probability that it will occur. Risk mapping should then, where applicable, enable the company to make all the necessary improvements to the existing risk management system and set priorities for the checks to be carried out.

2. Risk analysis and establishing or adapting the risk management system

The company's risk management system is made up of the permanent risk management function for financial and operational risks and the compliance function for risk of non-compliance. These functions have two main roles to play: advising and assisting the operational units and senior management, and ensuring that the systems put in place are robust and applied correctly. They are responsible for monitoring the effectiveness of the company's existing risk management and periodically mapping risks so that any necessary changes to said system can be made.

³ See Articles 313-53-3 of the AMF General Regulation or 40-2 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012

2.1. Managing financial and operational risk

2.1.1. Risk management policy⁴

The risk management policy aims to describe and explain the measures and procedures used by the AMC to manage the risks to which it is exposed.

It should be formalised and documented and include all procedures enabling the investment manager to assess exposure to market, liquidity, counterparty and operational risks for each collective investment scheme or managed portfolio. The risk management policy should be tailored to the company's business and reviewed and approved periodically by senior management in order to ensure its effectiveness.

It must provide details of:

- the organisation and governance of the permanent risk management function (appointment of a function head, where applicable, profiles of those persons involved in managing risks, independence of the permanent risk management function from the operational functions, where applicable);
- the process used to set collective investment scheme risk profiles;
- the techniques and tools used to:
 - o measure and manage the risks to which the collective investment schemes and managed portfolios are, or could be, exposed
 - o ensure compliance with the limits applicable to collective investment schemes in terms of global and counterparty risk
- the content and frequency of reports to the board of directors, senior managers and , where applicable, supervisory bodies.

In compliance with Article 5 of AMF Instruction No. 2012-01, where individual managed portfolios share exactly the same risk profile and asset breakdown, the risk management policy and procedures can be implemented by family of portfolios. The AMC is responsible for this analysis and should be able to justify it at any given moment.

2.1.2. Permanent risk management function

The permanent risk management function is the body within the AMC responsible for implementing the risk management policy.

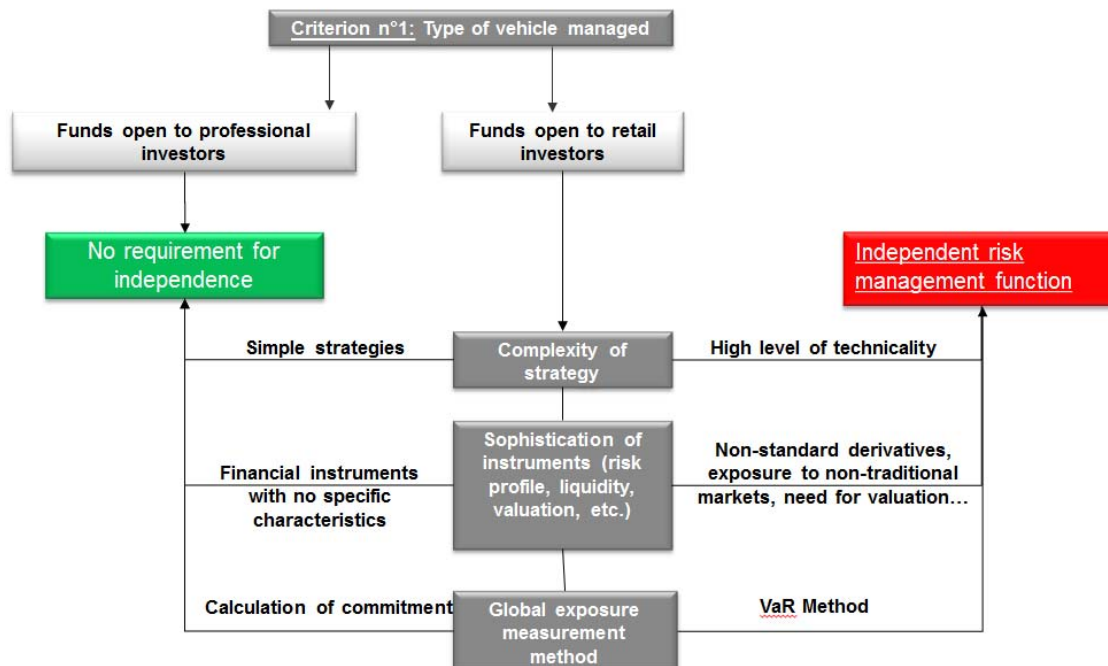
Pursuant to Articles 313-53-4, 318-38 and 318-39 of the AMF General Regulation, AMCs should establish and maintain a permanent risk management function that is independent from the operational units in terms of both hierarchy and function. However, this does not apply if the nature and complexity of the AMC does not require the function to be independent.

Position

If an AMC has not set up a permanent risk management function that is independent from the operational units in terms of both hierarchy and function, it must explain this to the AMF by indicating in its programme of operations the reasons it is exempt from this obligation.

⁴ See Articles 313-53-5 of the AMF General Regulation or 40 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012

2.1.2.1. Independence of the permanent risk management function



In compliance with the provisions of Articles 313-53-4 and 318-38 of the AMF General Regulation, the permanent risk management function must be independent from the operational units (i.e. the management team) in terms of both hierarchy and function, subject to application of the principle of proportionality.

This principle of proportionality is assessed based on different criteria such as the target client base (and therefore also the type of investment vehicle managed) and the degree of complexity of the strategies and instruments used. This assessment assumes that experienced investors are more likely than retail investors to understand the risks associated with a given strategy, conduct their own due diligence with regard to the AMC's risk management system and invest with full knowledge of the facts.

AMF Instruction No. 2012-01 states that:

The permanent risk management function must be independent in the following situations⁵:

1° If the strategies implemented in the collective investment schemes or discretionary portfolios (portfolio management for third parties), or the risk measurement techniques for said strategies, are particularly technical.

For example, the permanent risk management function must be independent if the AMC implements any kind of trade-off strategy that aims to profit from arbitrage opportunities on one or several asset classes, or strategies whose performance driver is based on non-standard risks (such as volatility, correlations or anticipating dividend yields).

2° If the AMC uses any of the following in its collective investment schemes or discretionary portfolios:

- non-standard derivatives as defined in Instruction No. 2011-15 on global exposure for UCITS;
- eligible financial securities and money market instruments with non-standard embedded derivatives;
- financial instruments posing particular valuation and/or liquidity difficulties (for example, contingent convertible bonds, commonly known as "CoCos"⁶);

⁵ See Article 3 of AMF Instruction No. 2012-01

- financial instruments with material exposure to markets other than traditional markets (equity market, fixed income market and money market), such as financial instruments whose performance depends significantly on credit or foreign exchange risk, or on commodities.

3° Lastly, if the AMC uses the Value at Risk calculation method to measure global risk.

However, the risk management function does not have to be independent from the operational units if the AMC:

- 1° provides only a discretionary portfolio management service to professional clients or similar;
- 2° manages only funds open to professional investors such as general purpose professional funds, professional private equity funds, specialised professional funds or equivalent foreign-law funds.

NB: These exemptions from the need to establish a permanent risk management function that is independent from the operational units in no way absolve AMCs of their obligation to define a suitable risk management policy and procedures or mean a reduction in the quality of checks.

2.1.2.2. Human resources dedicated to the permanent risk management function

Regulations⁷ require that a permanent risk management function be set up but not that a head of said function be appointed. Articles 313-53-5 of the AMF General Regulation and 40 of Commission Delegated Regulation (EU) No. 231/2013 state merely that the risk management policy should cover the allocation of risk management responsibilities within the AMC. Depending on the situation, the permanent risk management function can be performed by:

- a senior manager or member of the management team, provided independence from the management team is not required;
- a risk manager, where independence is required.

Recommendation

If the permanent risk management function needs to be independent, the AMF recommends that this function be performed by someone other than the person responsible for the compliance function.

In order to guarantee the independence and authority of the permanent risk management function, the head of the function should report directly to one of the company's senior managers so that management is involved in defining and implementing the risk management system. In the case of a group, if an AMC appoints someone who has been seconded by another group entity as head of the permanent risk management function, the AMF recommends that this person reports to the senior manager of the AMC as part of his/her position at that company.

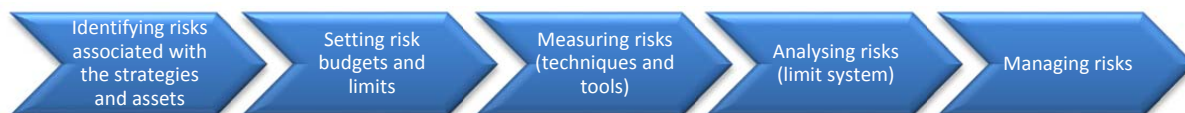
Position

If the permanent risk management and compliance functions are performed by the same person, the AMC must ensure: (i) that the person has the necessary experience and knowledge to successfully perform the tasks required by both functions; and (ii) that the company has implemented a system of periodic independent controls.

2.1.2.3. Tasks of the permanent risk management function

⁶ The term "CoCos" (short for "contingent convertibles" or "compulsory convertibles") is used here to refer to subordinated debt securities issued by credit institutions or insurance or reinsurance companies that are eligible in their regulatory capital and are unique in that they can be converted into shares or written down in the event of a predefined trigger occurring, as specified in the prospectus for the said debt securities.

⁷ See Articles 313-53-4 of the AMF General Regulation or 40-4 c) of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012



In practice, the AMCs draw up a risk management policy that includes all the necessary procedures enabling them to measure the exposure of each collective investment scheme or individual portfolio they manage to market, liquidity, counterparty or credit risk, as well as to any other potentially material risk, including operational risk.

Therefore, in practice, the AMCs identify the financial risks associated with their business and decide on measures to contain these risks.

The possible tasks of a permanent risk function are described below by way of an example.

a) Identifying and managing risks: the example of financial risks

- Risk mapping

In compliance with Article 5 of Instruction 2012-01, the risks to which the managed portfolios or funds are exposed cannot be identified or assessed without mapping. This means it is best to first analyse the portfolio holdings (individually and collectively) and the implemented strategies before establishing what types of risk are present.

Let us consider the example of a UCITS implementing a long equity strategy, which involves buying equities and betting that their price will rise so they can then be sold on at a profit. It should be remembered that the fund manager may exceptionally resort to specific financial techniques in order to hedge against certain risks.

To this end, the AMC may identify various market risks according to the strategy and the portfolio, and engage in the following mapping:

Composition of the portfolio:

- international equities, mainly from Europe and the US, EUR- and USD-denominated small and mid caps;
- EUR/USD currency swaps or futures as part of hedging forex risk on USD securities;
- cash pocket (money market AIFs and UCITS).

Investment strategy:

Stock-picking in expectation of an increase in share price.



A non-exhaustive possible risk map

| Family of risk | Type of risk | Source of risk |
|---|--|--|
| Market risks | Equity market risk | Equities |
| | Foreign exchange risk | US equities, currency swaps, currency futures |
| | Volatility risk | Equities |
| | Concentration risk | Concentration in a single market or sector |
| | Risk of poor analysis | Strategy |
| Liquidity risk | Risk of poor liquidity of portfolio assets | Small cap equities |
| Counterparty risk | Counterparty risk on over-the-counter derivatives used for hedging | Currency swaps |
| Invested-related operational risks | Settlement/delivery risk | All assets |
| | Legal risks arising from derivatives | Currency swaps |
| | Risk of restricted liquidity | Activation of <i>gates</i> in underlying AIFs |

This mapping provides the AMC with an overview of the risks to which it is exposed.

- Developing risk measurement indicators

At this stage, the AMC should determine how to qualify and quantify, where applicable, the risks that have been identified. This means determining for each risk some measurement indicators that may take the form of simple financial variables (like the Greek letters commonly used on the financial markets to monitor changes in the market value of positions in derivative financial instruments versus the underlying asset, interest rates, volatility, etc.) or may require the support of a more sophisticated model (monitoring the portfolio by risk budget or via a VaR, or performing stress tests to measure liquidity risk, etc.).

- Developing risk limitation systems

These measurement indicators should then be accompanied, where applicable, by maximum thresholds set by the AMC based on its own tolerance and that of its investors to the risks incurred (according to the documents drafted upon creation of the fund or managed portfolio).

These thresholds should be justifiable and remain fairly stable over time.

The following indicators and thresholds could be implemented for the previous example:

| Family of risk | Type of risk | Source of risk | Measurement indicator | Thresholds | Current level |
|-----------------------------------|--|---|--|----------------|---------------|
| Market risks | Equity market risk | Equities | Sharpe Ratio ⁸ of the portfolio | > 0.9 | 1 |
| | | | VaR of the portfolio (99%, 1d), historical model | 5% | 4% |
| | | | Historical maximum 1-month loss (<i>maximum drawdown</i>) by position | -20% | |
| | Foreign exchange risk | US equities, currency swaps, currency futures | Historical maximum 1-month loss (<i>maximum drawdown</i>) | -20% | |
| | Volatility risk | Equities | Annualised daily volatility | Max. 12% | 10% |
| | | | Annualised monthly volatility | Max. 10% | 9% |
| | Concentration risk | Concentration in a single market or sector | Diversification ratio by geographical zone | 15% | |
| | | | Diversification ratio by business segment | 15% | |
| Risk of poor analysis | Strategy | Stop orders on equity positions | -50% | | |
| Liquidity risk | Risk of poor liquidity of portfolio assets | Small cap equities | Number of days to liquidate the positions | 3 days | 3 days |
| | | | Number of days to liquidate the positions according to stress tests, scenario based on a 30% fall in share prices. | 10 days | 11 days |
| Counterparty risk | Counterparty risk on over-the-counter derivatives used for hedging | Currency swaps | Exposure to a single counterparty | 5% | |
| | | | Diversification of collateral received | 10% per issuer | |
| Invested-related operational risk | Settlement/delivery risk | All assets | | | |
| | Legal risks arising from derivatives | Currency swaps | | | |
| | Risk of restricted liquidity | Activation of <i>gates</i> in underlying AIFs | | | |

- Implementing alert mechanisms

In compliance with Article 5 of AMF Instruction No. 2012-01, alert mechanisms must be implemented for each of these indicators in order to quickly detect any breach of threshold. A response procedure should be set up.

If the daily potential loss level tolerated for a given security is ever exceeded, the AMC should have in place a series of measures it can take, such as partly or fully closing the position or hedging against market risk.

- Using indicators

⁸ The Sharpe Ratio measures the risk-adjusted return of a portfolio of financial assets.

The permanent risk management function implements the indicators defined in the risk management policy. In the previous example, the function would be responsible for:

- checking the suitability of the value at risk (VaR) model by analysing the pertinence of the theoretical basis and the assumptions made (the following questions could be asked: Is the performance distribution normal? Does the model capture the risks of optional positions? Is choosing a window detrimental? Have specific risks been underestimated?);
 - approving the domain of validity, for example by identifying market situations where the VaR indicator would no longer be sufficient (in this example once the assumption of normal returns is no longer valid);
 - implementing the model from an IT perspective or ensuring a third party within the AMC (e.g. the management team) has done this, and performing reliability tests such as reviewing the source code and auditing a proprietary file);
 - reviewing the parameters used (is a layer of volatility required? How should the implied volatilities be restated to obtain this layer?);
 - ensuring the model is relevant in the knowledge that atypical market movements in a given period may require a review of models.
- Measuring risk over the lifetime of an investment

The permanent risk management function is responsible for measuring risk levels at a suitable regularity, based on the indicators established, and for ensuring compliance with the defined limitation system, based on the alerts generated.

In the previous example, the Sharpe Ratio is measured at 0.5 and the acceptable threshold is 0.9, so this automatically generates a breach alert.

| Family of risk | Type of risk | Source of risk | Measurement indicator | Thresh olds | Current level | |
|----------------|--------------------|----------------|--|-------------|---------------|--------|
| Market risks | Equity market risk | Equities | Sharpe Ratio of the portfolio | > 0.9 | 0.5 | Breach |
| | | | VaR of the portfolio (99%, 1d), historical model | 5% | 4.8% | |

- Helping to value the financial instruments

In compliance with Article 9 of AMF Instruction No. 2012-01 and Article 70 of Regulation No. 231/2013, the permanent risk management function contributes to the valuation of financial instruments, particularly over-the-counter instruments. In order to do this, it:

- plays a part in validating the valuation model used and in validating the models underlying the risk monitoring indicators⁹.
- also plays a part if there is a discrepancy in valuations, i.e. a difference between the value produced by the management team with the help of the model and that of the counterparty, by revaluing the instrument and determining the source of the discrepancy.
- validates the solution or procedure implemented by the management team.

b) Periodically reviewing the risk management policy

In compliance with Article 313-53-6 of the AMF General Regulation and Article 41 of Regulation 231/2013, the permanent risk management function should periodically review the risk management policy and ensure it is still suited to the AMC's business and to changes in markets and products. If it is not, the function should decide to revise the policy. This could happen, for example, after a new type of asset is added to the portfolio.

⁹ For example, it checks the consistency of the valuation model used for a European vanilla call option, typically the Black-Scholes model. It will oppose the use of this model to value a barrier option and will suggest the use instead of a Monte Carlo method taking into account the path dependence of the financial instrument.

c) Informing senior management about compliance with the risk management policy

In compliance with Article 313-53-4 of the AMF General Regulation and Article 39 of Commission Delegated Regulation (EU) No. 231/2013, the permanent risk management function regularly reports to the board of directors or senior management on:

- the consistency between the current risk levels and the risk profile for each collective investment scheme or discretionary portfolio;
- whether each collective investment scheme or discretionary portfolio complies with the relevant risk limitation systems;
- the suitability and effectiveness of the risk management method, specifying whether appropriate corrective measures have been taken where required.

2.2. Managing the risk of non-compliance

2.2.1. Organising the compliance function



The AMCs should establish and maintain adequate policies, procedures and measures for detecting any risk of non-compliance with the professional obligations incumbent upon them pursuant to Article L. 621-15 of the Monetary and Financial Code¹⁰. They should develop a risk-based approach by regularly assessing the risk of non-compliance.

¹⁰ See Articles 313-1 or 318-4 of the AMF General Regulation.

Position

The AMCs periodically map their risk of non-compliance. This mapping should enable them to set the targets, resources and work programme of the compliance function. The work programme and resources of the compliance function should be reviewed regularly to take into account any risk arising, for example, from the launch of a new business.

The compliance function performs two essential tasks: supporting and advising the operational units and senior management, and performing checks on the compliance system (see below)¹¹. An effective compliance function needs to have: (i) its authority recognised within the company; (ii) sufficient human and technical resources; (iii) expertise aligned with the business of the company; and (iv) access to all the information it needs to perform its duties.

2.2.1.1. Applying AMF Position DOC-2012-17 to AMCs that manage UCITS or AIFs

AMF Position DOC-2012-17 includes ESMA guidelines on “certain aspects of the MiFID compliance function requirements” (2012/388)¹².

AMF Position DOC-2012-17 mainly specifies:

- the responsibility of investment service providers in terms of the assessment of the risk of non-compliance and the monitoring, reporting and advisory obligations of the compliance function;
- the organisational requirements of the compliance function enabling it to operate efficiently and independently.

In order to standardise the compliance function rules applicable to AMCs, the AMF decided to extend the scope of application of Position 2012-17 to cover the UCITS or AIF management business of AMCs.

2.2.1.2. Independence and authority of the compliance function

The AMCs should ensure that the compliance function is independent and that the compliance officer's position at the company guarantees the independence and authority of those people involved in the compliance function. The people involved in the compliance function should not be involved in the execution of the services and activities they are responsible for auditing¹³.

Recommendation

In order to guarantee the independence and authority of the compliance function, the compliance and internal control officer should report directly to one of the AMC's senior managers so that management is involved in defining and implementing the compliance and internal audit system. The AMF recommends that, where possible, the compliance and internal control officer report to a senior manager not responsible for operational activities. The AMF stresses that an AMC's senior managers are responsible for ensuring that the company fulfils its professional obligations.

If an AMC appoints someone who has been seconded by another group entity as compliance and internal control officer, the AMF recommends that this person report hierarchically to the senior manager of the AMC as part of his/her position at that company and, where applicable, report functionally to the group business line in order to benefit from the group's practices and expertise.

2.2.1.3. Permanence of the compliance function

¹¹ See Article 313-2 of the AMF General Regulation or Article 61 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 for the management of AIFs.

¹² These guidelines have been enacted on the basis of the Markets in Financial Instruments Directive (2004/39/EC) and MiFID implementing directive (2006/73/EC), transposed into national law in the Monetary and Financial Code and in the AMF General Regulation

¹³ See Article 313-3 of the AMF General Regulation or Article 61 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012.

Position

The AMCs should ensure that the compliance function is able to fulfil its duties and responsibilities on a permanent basis, including in the absence of the compliance and internal control officer.

2.2.2. Advisory and support duties

The AMC should ensure that the compliance function is able to fulfil its responsibilities with regard to advising and supporting the operational units and senior management. Position 2012-17 states that the compliance function should therefore:

- be involved with all corporate projects likely to generate the risk of non-compliance, e.g. launching new products or a new marketing campaign;
- be involved with drawing up corporate policies and procedures relating to the collective investment management and discretionary management businesses and to the sale of collective investments;
- provide training to the relevant people on all subjects associated with managing the risk of non-compliance (e.g. regulations and new policies or internal procedures at the AMC).

2.2.3. Delegation of compliance function duties

In compliance with the provisions of Article 313-3 of the AMF General Regulation and Article 61.3 of Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 for the management of AIFs, the AMC should ensure that the compliance officer has the necessary authority, expertise and resources to perform his/her duties. If the AMC appoints one of its senior managers with operational functions as compliance and internal control officer, the compliance function's duties should be assigned either to an external service provider or to an employee of the company or of another group entity or from the same central body. The company's senior management remains responsible for ensuring adherence to compliance function requirements.

Position

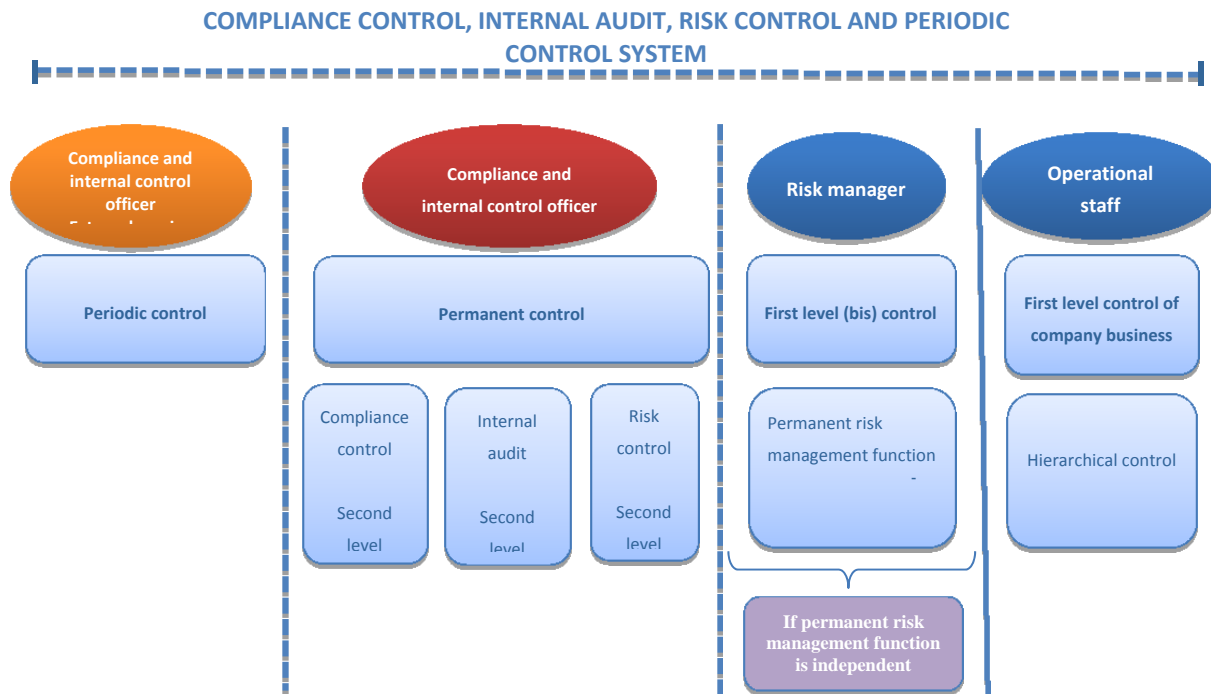
If the AMC appoints an external service provider or employee from another group entity as compliance and internal control officer, it should always ensure that the time dedicated to the role of compliance and internal control officer is sufficient in relation to the company's business and size. The compliance function must operate on a permanent basis.

Recommendation

If the role of compliance and internal control officer is assigned to a senior manager who delegates the duties of the compliance function to one of his/her employees, it is preferable that this employee is also appointed compliance and internal control officer, provided he/she has the necessary expertise and experience.

3. Organisation of the compliance control, internal audit, risk control and periodic control system

3.1. Overview of the system



The AMCs should establish and maintain suitable internal audit mechanisms designed to ensure compliance with decisions and procedures at all levels of the company. The AMCs' compliance and internal audit system should include a set of resources, behaviours, procedures and actions tailored to the specific characteristics of each company in order to ensure that the risks resulting from their business are managed.

Pursuant to Articles 313-65 and 318-51 of the AMF General Regulation, the organisation of the compliance, internal audit and risk system depends on first level controls performed by people in operational positions and second level controls performed by the permanent control function, which ensures that first level controls are properly executed.

Position

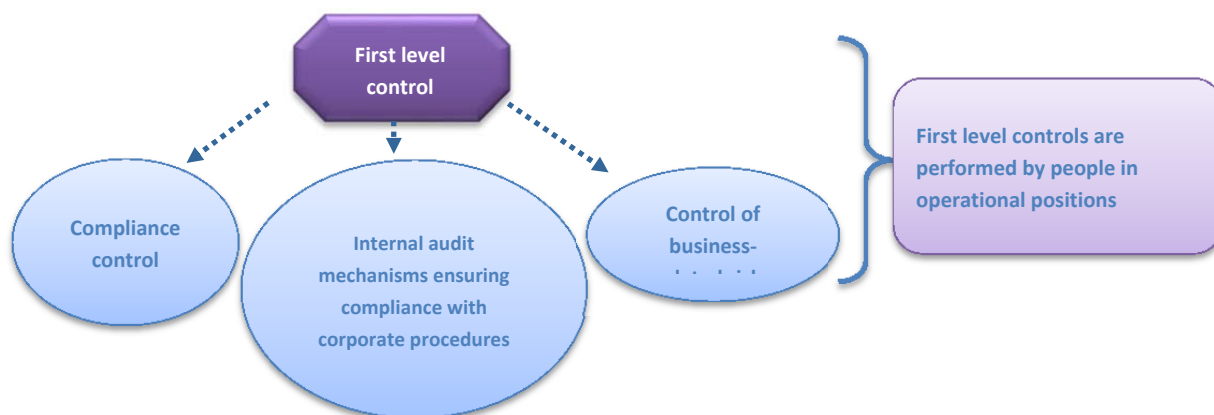
If an independent permanent risk management function is not required, the function can be performed by senior management or operational staff. The compliance and internal control officer ensures that the risk management system is effective and being applied by the operational units.

If the business of the AMC dictates that the permanent risk management function be independent from the operational units (see above), thereby constituting an intermediary first level (bis) control, the compliance and internal control officer should ensure as part of his/her control duties that the risk management system is effective and operational.

Lastly, under the conditions set forth in Article 313-62 for the management of UCITS and discretionary management and in Article 62 of Commission Delegated Regulation (EU) No. 231/2013 for the management of AIFs, the AMCs should establish an audit function that can ensure the effectiveness of the compliance and internal audit system by way of business audits and recommending corrective measures for any faults uncovered.

3.2. First level control system

3.2.1. Overall presentation



Position

First level controls are performed by people in operational positions¹⁴. These controls can be performed by line managers or dedicated teams. They aim to ensure compliance with all corporate policies and procedures.

With regard to risk control, two situations may arise depending on whether or not the permanent risk management function is independent from the operational units.

3.2.2. Organisation of the control system with regard to risk management - general example

Whether or not the permanent risk management function depends on the operational teams, it is always responsible for implementing the risk management policy and procedures, as mentioned above.

a) If the permanent risk management function is independent from the operational units

The permanent risk management function is responsible for checking that the operational units comply with the risk management policy and procedures. As part of this, it ensures that for each collective investment scheme and discretionary portfolio managed, the manager respects the qualitative and quantitative limits set in relation to controlling market, credit, liquidity, counterparty and operational risk. In particular, ex-post checks are used to ensure compliance with all limits set by the risk management policy. If faults are uncovered, the permanent risk management function informs the company's senior management and ensures that corrective measures are implemented quickly and in line with investors' interests.

b) If the permanent risk management function depends on the operational units

The fund manager is responsible for checking compliance with the fixed limits. Consequently, as part of his/her permanent control duties, the compliance and internal control officer performs second level controls to ensure that the company's risk management system is effective. He/she ensures the existence and effectiveness of the permanent risk management function and that the defined risk management policy is being applied.

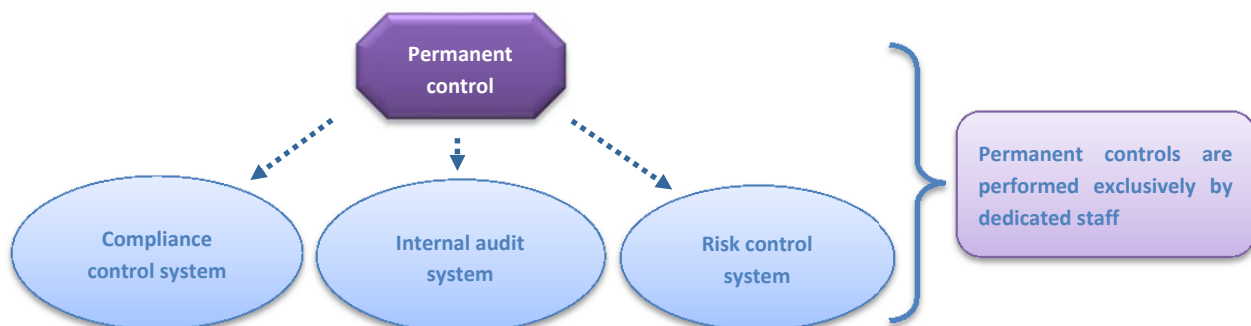
Recommendation

The permanent risk management function should not be assigned to the compliance and internal control officer because the audit duties of the compliance function include checks on the permanent risk management function.

¹⁴ See Articles 313-65 or 318-51 of the AMF General Regulation.

Having said that, the AMF will assess on a case-by-case basis requests for the compliance and internal control officer to also be responsible for the permanent risk management function. As part of its analysis, the AMF will consider the profile of the compliance and internal control officer and any specific characteristics of the company.

3.3. Second level permanent control system



The permanent control system includes the compliance control system, the internal audit system and the risk control system¹⁵. The permanent control system uses second level controls to ensure that the first level controls have been properly executed. Permanent controls are performed exclusively by dedicated staff¹⁶.

The compliance and internal control officer is responsible for the compliance, permanent control and periodic control function in cases where the company does not set up an independent periodic control function¹⁷. However, provided such a decision can be justified, the company can assign responsibility for permanent controls to two different people, with one in charge of non-compliance permanent controls and the other in charge of compliance¹⁸.

The AMCs should ensure that the compliance and internal control officer draws up a comprehensive audit schedule for all the company's activities, with the aim of ensuring that the compliance, internal audit and risk system is suited to the company's business and adhered to by the people concerned.

In addition, the AMC should ensure that its supervisory body receives written reports on compliance at least once a year¹⁹

Position

Permanent controls should be documented. If faults are uncovered or the observed situation fails to meet expectations, the compliance function should inform senior management of the facts and of the corrective measures that should be taken. The compliance and internal control officer monitors the implementation of the corrective measures he/she recommends and informs senior management on the appropriate measures taken in compliance reports.

3.4. Periodic control system

The AMCs should implement and maintain a separate periodic control function that is independent from its other functions, subject to application of the principle of proportionality²⁰. By virtue of this principle,

¹⁵ See Articles 313-64 or 318-50 of the AMF General Regulation.

¹⁶ See Articles 313-65 or 318-51 of the AMF General Regulation.

¹⁷ See Articles 313-66 or 318-52 of the AMF General Regulation.

¹⁸ See Articles 313-70 or 318-56 of the AMF General Regulation.

¹⁹ See Article 313-7 of the AMF General Regulation and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 for the management of AIFs.

²⁰ See Article 313-62 of the AMF General Regulation or Article 62 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 for the management of AIFs.

AMCs are not required to set up an independent periodic control function if such an obligation is disproportionate to the nature, scale, complexity and diversity of its activities.



From an organisational perspective, the periodic control function should not be grouped together with the compliance and internal audit functions because the periodic control function is responsible for auditing the other two functions. AMF Position No. 2012-17 on compliance function requirements also states: *“Combining the compliance function with the internal audit function shall generally be avoided as this is likely to undermine the independence of the compliance function because the internal audit function is charged with the oversight of the compliance function. However, for practical reasons and in certain circumstances (for example, in companies of only two persons), it may be more appropriate to have one person responsible for both functions. In this regard, investment services providers shall consider discussing the combination with the relevant supervisory authority.”*

Nevertheless, if an AMC believes that setting up an independent periodic control function would be excessive, it must be able to prove to the AMF that establishing such a function would be disproportionate to its size and business.

In addition, the AMC should ensure that its supervisory body receives written reports on periodic controls at least once a year²¹.

Recommendation

If the AMC does not belong to a group, the periodic control function should preferably be assigned to an external service provider. If the AMC does belong to a group, the group’s internal audit teams can perform periodic control tasks within the AMC.

If the principle of proportionality is being applied and the compliance and internal control officer is also the risk manager, he/she should not perform periodic controls. In this case, the AMC should assign the company’s periodic control function to an external service provider.

Periodic controls may be performed annually or over several years.

²¹ See Article 313-7 of the AMF General Regulation and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 for the management of AIFs.