

## GUIDE RELATING TO EMPLOYEE INVESTMENT UNDERTAKINGS

References: Articles L. 214-163 et seqq. of the Monetary and Financial Code, Articles 424-1 et seqq. of the AMF General Regulation and Articles L. 3332-16 and L. 3332-17 of the French Labour Code

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Except where recommendations are specifically identified, elements of policy included in this document are positions.

## 1. PROCEDURES FOR IMPLEMENTING A CAPITAL INCREASE VIA A TEMPORARY FUND WITH OR WITHOUT A REGULAR SAVING SCHEME

### 1.1. Principles of establishment of the temporary fund

#### 1.1.1. What is a temporary fund?

A temporary fund is an employee investment undertaking for the purpose of subscribing to a capital increase reserved for employees.

Its operating procedure is described in Article 31-6 of AMF Instruction DOC-2011-21 relating to authorisation procedures, preparation of a KIID and a prospectus and periodic reporting for employee investment undertakings. Use of the temporary fund mechanism is necessary when, in the company savings plan, there already exists an employee investment undertaking for employee savings invested in the company's securities, to which the subscribed shares are to be contributed.

This fund, initially invested in money market products, subsequently subscribes to the capital increase reserved for employees and then, upon a decision of the supervisory board and after authorisation by the AMF, merges with the existing investment undertaking.

The composition and procedure for election or appointment of the supervisory board shall be indicated in the temporary fund's rules.

#### 1.1.2. What is the use of a temporary fund?

The temporary fund mechanism is used for two reasons:

- It makes it possible to collect employees' savings with a view to subscribing to the capital increase and to manage those sums of money during the period preceding the fund's subscription to the capital increase.
- When the employees benefit from a discount on the share price, it makes it possible to maintain this advantage for them. If the subscription were made directly in the fund already invested in the company's securities, the discount would be diluted over the entire fund and would benefit all its unitholders without distinction, and not just those taking part in the capital increase.

#### 1.1.3. Can a temporary fund be created without having all the information regarding the conditions of execution of the capital increase?

Yes, it is possible to establish a temporary fund as soon as the principle of a capital increase has been approved by a vote of the annual general meeting. In that case, if the conditions of the capital increase are not yet known, they must be determinable. The method for determining these conditions is described in the Key Investor Information Document and in the fund's rules.

Regarding the determinable nature of the conditions of the capital increase, the AMF would like to make the following clarifications:

- As regards the price, if it has not been determined, the method of determination is described in accordance with the provisions of Articles L. 3332-19 to L.3332-24 of the French Labour Code. The price calculation procedures and the level of any discount granted to the employees must be indicated;

- As regards the date of the capital increase, if it has not yet been determined, the extraordinary general meeting must nevertheless have authorised the increase and defined the procedures for its implementation.<sup>1</sup>

1.1.4. What are the specific features of a temporary fund when the conditions of the capital increase are not yet known?

In that case, in accordance with the procedures specified in the Key Investor Information Document, the subscribers shall be informed of the date and price as soon as they have been determined, and informed that they will benefit from a cooling-off period.

The cooling-off period is designed to enable members of the employee savings plan not to subscribe to the capital increase. It is only after being informed of the final conditions in which the capital increase will take place that they are truly capable of assessing their interest in subscribing to it.

The cooling-off period is limited in time. The Key Investor Information Document specifies its starting date<sup>2</sup> and its duration, which must be reasonable. The start of this cooling-off period is materialised by sending a withdrawal form to the subscriber.

There are then two possible cases: either the member does not respond and it is thereby deduced that they wish to take part in the capital increase; or the member decides, by a personal decision, to reallocate their savings<sup>3</sup> to another investment vehicle available in the plan, by means of their withdrawal form.

If the withdrawal takes place even before the amounts subscribed to by the member have been paid up, it then takes the form of a cancellation of the subscriptions.<sup>4</sup>

1.1.5. What are the special procedures to be complied with when an employee or a former employee subscribes to the temporary fund?

Like for any other employee investment undertaking, subscription to the temporary fund will be performed via a subscription form. It is worth remembering that the subscription is made to the temporary fund<sup>5</sup> and not to the investment undertaking with which it is to be merged.

Due to the special nature of temporary funds, when subscribing to the fund, the member of the plan receives not only the fund's Key Investor Information Document, but also that of the ultimate investment undertaking if the latter has not been indicated to them previously.

The subscription to a temporary fund may take the form of an arbitrage operation. In that case the money comes from investments made in one or more other employee investment undertakings that are investment vehicles of the company savings plan.

1.1.6. What documents must be forwarded to the AMF when filing a dossier of application for the authorisation of a temporary fund?

<sup>1</sup> The general meeting shall have at least delegated to the management board or the board of directors the power to determine the procedures for the share issue (Article L. 225-129-1 of the French Commercial Code).

<sup>2</sup> The cooling-off period cannot start until the subscribers have received information on the date and price of execution of the capital increase.

<sup>3</sup> The amounts invested in the temporary fund remain locked in the company savings plan.

<sup>4</sup> This situation occurs notably in the specific case of capital increases reserved for employees located in various countries. The collection and centralisation of payments may therefore require fairly long processing times.

<sup>5</sup> The temporary fund is different from the investment undertaking to the extent that its name includes the word "temporary".

In addition to the documents customarily required and listed in AMF Instruction DOC-2011-21, the following documents are requested during the study of the dossier of application for authorisation:

- If the temporary fund is formed when the conditions of the capital increase are known, all the reports relating to the capital increase, the commercial documents and the subscription form;
- If the temporary fund is formed when the conditions of the capital increase are determinable, in addition to the documents mentioned above, a provisional timeline drawn up by the company shall be provided giving the essential dates of the operation, as well as the withdrawal form.

The temporary fund's Key Investor Information Document specifies the rules for reduction and allocation of any "over-subscriptions".

1.1.7. What is the foreseeable communication by the company with regard to its employees?

#### **Recommendation**

**Given the complexity of the temporary fund scheme, it is recommended that communication regarding this type of dossier should be instructive and be performed during all the decisive stages of the unitholder's commitment to the fund. It may be performed ahead of the various operations if it proves to be sufficiently general.**

However, it should be noted that, like for any AIF subject to an authorisation procedure, any specific communication regarding a temporary employee investment undertaking, any collection, subscription or commitment to subscribe savings can be performed only after the management company has been notified by the AMF of the authorisation of the temporary employee investment undertaking.

## **1.2. Can the practice of temporary funds be applied to regular saving schemes?**

1.2.1. What is a regular saving scheme?

Some companies allow their employees to allocate part of their salary every month to the formation of savings invested via a company savings plan. The regular saving investor can terminate or modify the scheme at any time. The practical procedures for modification or termination are described in the subscription form.

1.2.2. Can the regular saving mechanism be a means to collect savings with a view to subscribing to a capital increase?

Yes, authorisation dossiers have illustrated the use of regular saving schemes for capital increases reserved for employees, where the regular saving scheme offers the holder the possibility of constant savings, often each month, far in advance of the capital increase.

However, the temporary fund mechanism was not originally created for this purpose. It was established as part of very conventional schemes in which the temporary fund is established shortly before the capital increase, with subscription taking place in a single operation. In this way, the employee is fully aware they are subscribing to a capital increase.

Conversely, the complexity of the regular saving scheme tends to reduce the holder's awareness of taking part in the capital increase. When it is used, therefore, the management company must pay special attention to the information to be provided for the subscriber. Before subscribing, the subscriber is informed of the sequence of

operations relating to the capital increase.<sup>6</sup> In particular, they are informed of all the investment vehicles to which their savings will be allocated, and the procedures for dissemination of information which will be necessary to correctly understand the information.

1.2.3. What schemes, for example, could meet both the requirements related to the establishment of a temporary fund and the requirements for correct information of the subscriber?

The two schemes presented below, while meeting these two requirements, allow the collection of savings far in advance of execution of the capital increase, i.e. as soon as the extraordinary general meeting has passed a resolution authorising the implementation of the capital increase reserved for employees:<sup>7</sup>

- Scheme 1: Subscriptions are allocated directly to the temporary fund.
- Scheme 2: Subscriptions are initially allocated to a transition fund, then a temporary fund.

Scheme 1 has the advantage of simplicity of execution, since a single fund is established. It is easy for the employees to use, because they subscribe a single time to the fund designed to contribute to the capital increase.

They enjoy a right of withdrawal and allocation to another investment vehicle if the conditions of the capital increase are not known at the time of their subscription.

Scheme 2 allows the collection of the employees' savings further in advance of execution of the capital increase; however, it implies two separate subscription acts for members of the plan, requiring that the management company produce two publications on the fund. However, for the holders, this scheme has the advantage that they can allocate their savings to different investment vehicles at any time.

1.2.4. Are there other schemes that could be considered?

The two schemes presented are alternatives, and do not represent the only possible arrangements for regular saving schemes.

The regular saving scheme can be applied not only to a vehicle to be used for subscribing directly or indirectly to a capital increase, but also to any other diversified vehicle of the plan. The amounts saved, or part of them, can subsequently be used to subscribe to the temporary fund via arbitrage operations.

Legend:

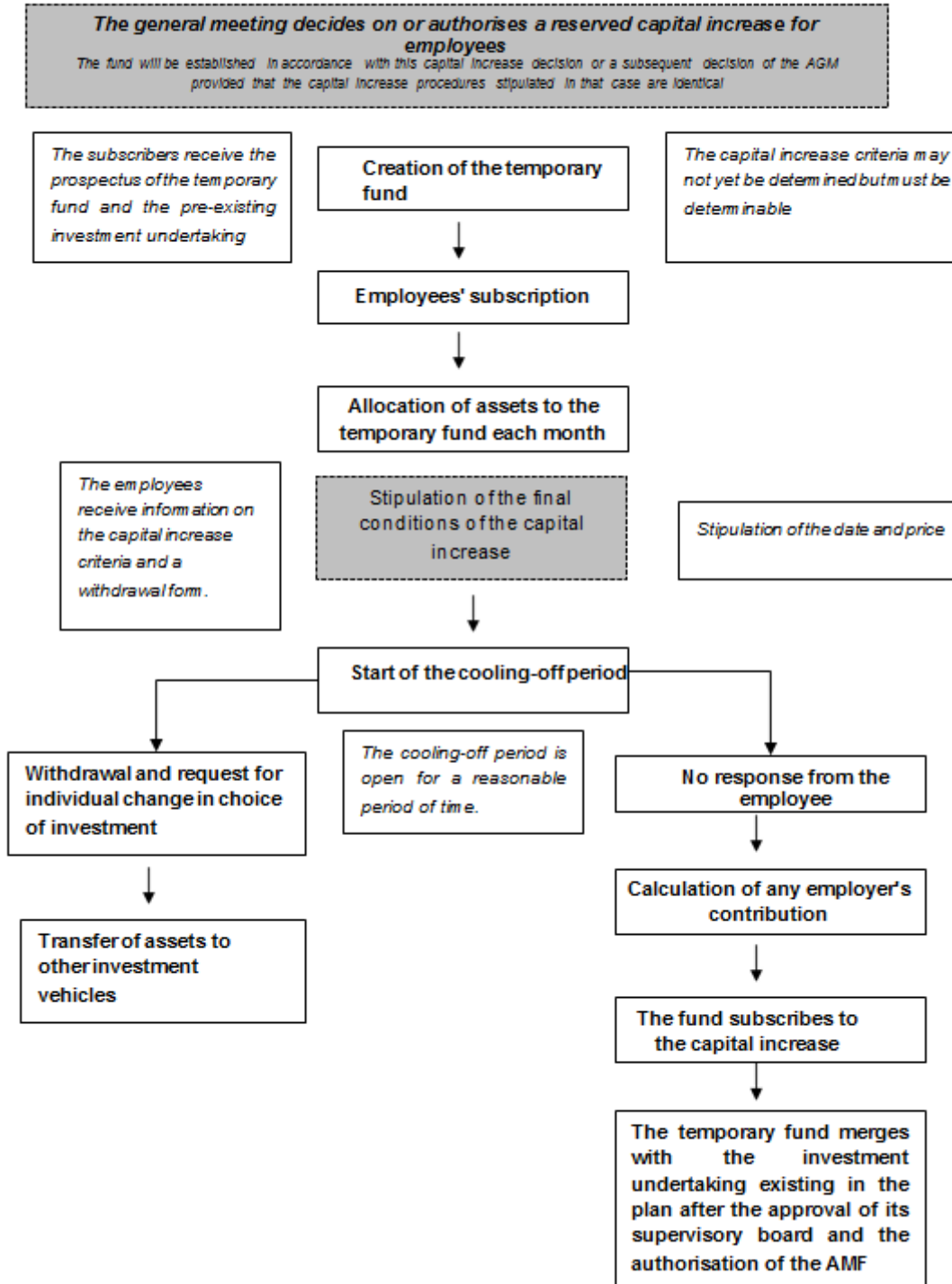
<b>Events related to the use of an FCPE employee investment fund</b>
Events related to a capital increase
<i>Comments</i>

<sup>6</sup> Cf. Schemes 1 and 2 below.

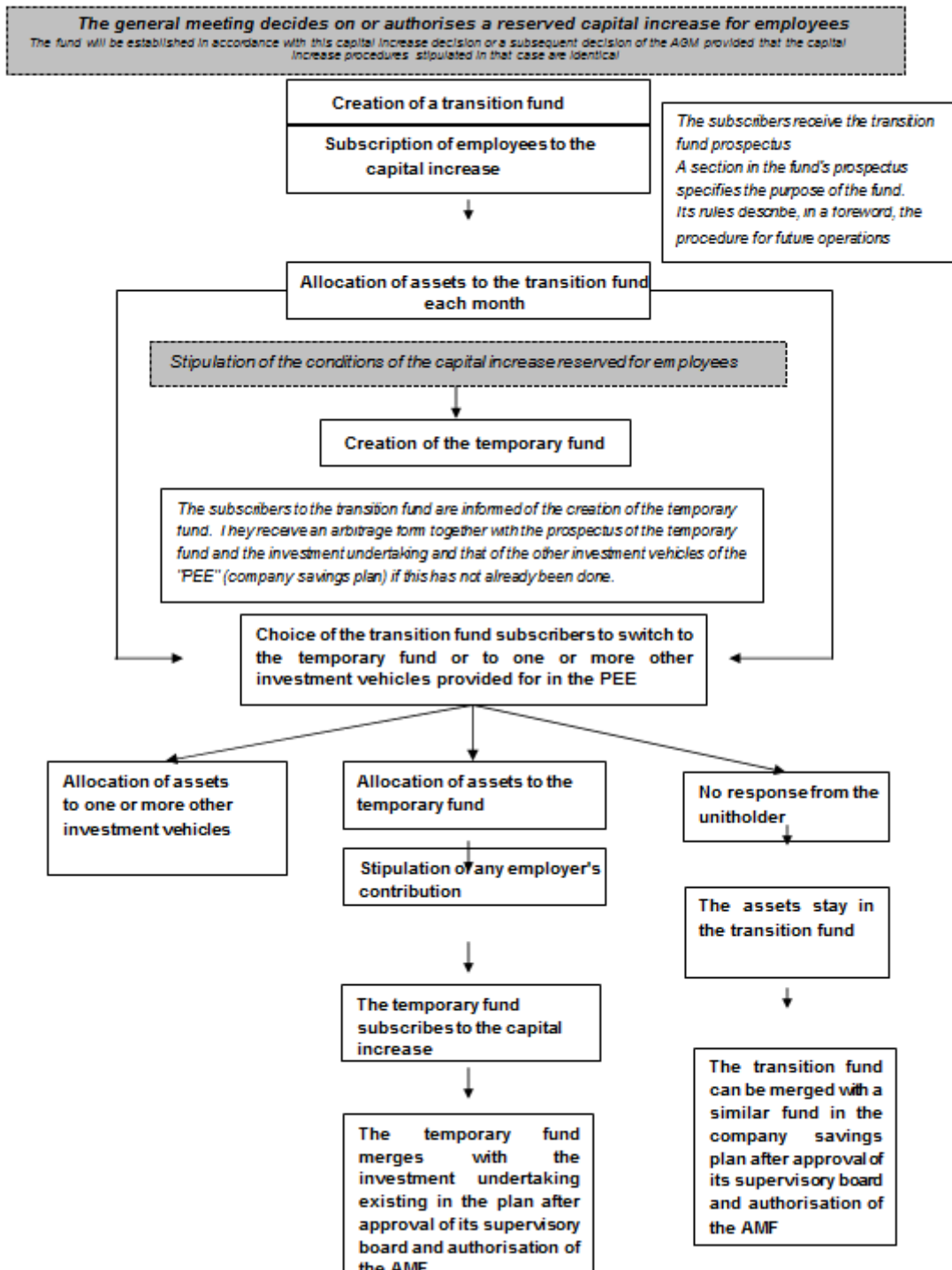
<sup>7</sup> In accordance with Articles L. 225-129-1 and L. 225-129-2 of the French Commercial Code.



**Plan 1: The subscriptions are allocated directly to the temporary fund**



**Plan 2: The subscriptions are allocated initially to a transition fund, then to a temporary fund**



### **1.3. Cancellation or postponement of capital increases in employee investment undertakings and impact on the temporary fund**

In the event of the postponement or cancellation of a capital increase, in light of the uncertainty regarding its execution, it does not seem possible to extend the life of the temporary fund indefinitely. Accordingly, the management company must indicate to the unitholders a new date of execution of the capital increase or a date on which, barring said execution, it would be advisable to go back to the employees and propose to them the transfer of their assets to other funds. This information shall be presented to the AMF prior to its circulation. This information may also be supplemented by a proposal for a takeover of the temporary fund by an appropriate vehicle.

## **2. EMPLOYEE INVESTMENT UNDERTAKINGS INVESTED IN SECURITIES OF THE COMPANY THAT ARE NOT ADMITTED FOR TRADING ON A REGULATED MARKET**

Since their creation in 1967, employee investment undertakings represent the preferred investment vehicle of employee savings schemes. These specialist AIFs, reserved for the employees of companies having established a profit sharing agreement or an employee savings plan,<sup>8</sup> may be reserved for the employees of a single company or a group of companies; in that case they are called individualised investment undertakings or group-individualised investment undertakings. If they are proposed simultaneously to several companies, they are called multi-company investment undertakings. Some individualised or group-individualised employee investment undertakings are invested in the securities of the company that established the employee savings plan. In that case they may have the special feature of not being subject to all the capital adequacy ratios legally applying to AIFs. The funds governed by Article L. 214-165 of the Monetary and Financial Code, called investment undertakings, can have more than one-third of their assets invested in the company's securities; some funds governed by Article L. 214-164 of said code may hold between 10% and one-third of their assets in the company's securities. The company's securities eligible as assets of these funds may be securities giving access to the capital or debt instruments, listed or unlisted.

The concentration of the investment and the nature of the securities held by these funds expose the unitholders to specific risks. The protection of the employee saver must therefore correspond to a threefold approach: clear information, strict liquidity management and a guarantee of fair valuation.

Complementing the AMF Instruction DOC-2011-21, the following questions and answers aim to answer the main questions that could be asked when a management company creates an employee investment undertaking invested in securities of the company that are not admitted for trading on a regulated market.

### **2.1. The liquidity mechanism**

#### **2.1.1. What are the measures enabling organisation of the funds' liquidity?**

Act 2001-152 of 19 February 2001 and Law 2006-1770 of 30 December 2006 organised the liquidity of employee investment undertakings invested in securities of the company that are not admitted for trading on a regulated market. For the sake of protection, the assets of employee investment undertakings invested in securities of the company that are not admitted for trading on a regulated market shall mandatorily include at least one-third of constantly liquid securities except if:

- a mechanism is established to ensure the liquidity of those securities;

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<sup>8</sup> Company savings plan (PEE), inter-company savings plan (PEI) and collective retirement savings plan (PERCO).

- the firm, the company which controls it or any company controlled by it in accordance with Article L. 233-16 of the French Commercial Code has agreed to buy back, within the limit of 10% of its registered capital, the securities not admitted for trading on a regulated market held by the employee investment undertaking.<sup>9</sup>

2.1.2. Is it possible to combine the first two liquidity mechanisms governed by Article L. 3332-17 of the French Labour Code?

It is possible to combine the first two methods, liquid securities in the fund's assets and a liquidity guarantee mechanism. Thus, for example, if the rules or articles of association of the employee investment undertaking provide that its assets must include 10% of liquid securities at all times, the AMF accepts the guarantee mechanism covering merely the difference between the required one-third and the 10% already established.

2.1.3. Can the absence of one-third of liquid securities in the fund's assets be grounds for suspending calculation of the net asset value?

The absence of one-third of liquid securities in the fund's assets cannot be grounds for suspending calculation of the net asset value. Such a suspension cannot be a means to organise management of the fund's liquidity and to exempt the management company from its obligation of maintaining the statutory level of liquidity at all times. Suspension can only take place in the event of exceptional circumstances and must be for the purpose of safeguarding the rights of the fund's unitholders in accordance with Article L. 214-24-41<sup>10</sup> of the Monetary and Financial Code.

It is therefore the management company's responsibility to establish a system for monitoring the level of liquid securities.

For example, the management company could alert a company which has agreed to buy back its own shares of the risk of passing below one-third of liquid securities. If the company cannot meet its commitments, the management company shall organise a plan for disposal of the securities to third parties where possible.

## 2.2. Mechanism 1: Liquid securities

2.2.1. Can the securities of companies traded outside of European regulated markets be considered liquid?

Article R. 214-214 of the Monetary and Financial Code defines liquid securities within the meaning of paragraph three of Article L. 3332-17 of the French Labour Code as:

- "Transferable securities which are admitted for trading on a French or foreign regulated market;
- Shares and units of UCITS and retail investment funds".

French regulated markets are defined in Article L. 421-1 of the Monetary and Financial Code. Foreign regulated markets are defined in Article L. 422-1 of said code: these are exclusively markets of a European Union Member State or of another State that is a party to the Agreement on the European Economic Area (EEA). Accordingly, the securities of companies traded exclusively on markets of countries which are not members of the European Union or are not parties to the EEA Agreement cannot benefit from the measures planned for liquid securities within the meaning of the Monetary and Financial Code. In practice, therefore, three situations may be encountered:

<sup>9</sup> Paragraph 3 of Article L. 3332-17 of the French Labour Code.

<sup>10</sup> Article L. 214-24-41 of the Monetary and Financial Code is applicable to retail investment funds and is applicable to employee investment undertakings referred to by Article L. 214-163 of the Monetary and Financial Code.

- The stock is listed on a foreign market outside the EEA and admitted for trading on a regulated market of a European Union Member State or of another State that is a party to the Agreement on the European Economic Area, and is considered liquid within the meaning of Article L. 3332-17 of the French Labour Code;
- The stock is listed on a foreign market outside the EEA, and the independent appraiser considers that the market depth is sufficient and therefore defines the valuation method as equal to the market price (e.g. a stock listed on the NYSE);
- The stock is admitted for trading on a foreign market outside the EEA, and the appraiser considers the market depth as insufficient and therefore does not adopt the market price, but defines a different valuation method.

### **2.3. Mechanism 2: Liquidity guarantee**

#### **2.3.1. Who can provide the liquidity guarantee mechanism?**

The persons capable of providing the liquidity mechanism mentioned in Article L. 3332-17 of the French Labour Code are defined in articles R. 214-214 of the Monetary and Financial Code and 424-8 of the AMF General Regulation. They are as follows:

- Credit institutions whose head office is located in a European Union Member State or another State that is a party to the Agreement on the European Economic Area;
- Insurance companies whose head office is located in a European Union Member State or another State that is a party to the Agreement on the European Economic Area;
- Natural or legal persons, other than the asset management company, the SICAVAS and the company whose securities are held by the employee investment undertaking, when the capital of said company is variable or when the company produces consolidated financial statements. In this case, the person's commitment to buy back the number of securities needed to provide liquidity at least equivalent to that which the employee investment undertaking would enjoy if it held at least one-third of liquid securities must be counter-guaranteed under the conditions of Article 424-8 of the AMF General Regulation (cf. below, question 2.3.5).
- The issuing company itself, when it has variable capital. In this case, as before, the company's commitment to buy back the number of securities needed to provide liquidity at least equivalent to that which the employee investment undertaking would enjoy if it held at least one-third of liquid securities must be counter-guaranteed under the conditions of Article 424-8 of the AMF General Regulation .

#### **2.3.2. What information must appear in the guarantee contract?**

In accordance with Article 424-9 of the AMF General Regulation, the information which must appear in the guarantee contract is specified in Article 30-10 of AMF Instruction DOC-2011-21 of 21 December 2011. This information is as follows:

- Names and contact details of the parties to the agreement;
- The percentage (or amount) of assets of the fund covered by the agreement;
- The date on which the agreement takes effect;
- The term of the agreement;
- The conditions of remuneration of the agreement;
- The procedure for terminating the agreement;
- The procedure for implementing the guarantee;
- Where applicable, the counter-guarantee procedure.

#### **2.3.3. What should be the minimum term of the guarantee contract?**

In order to ensure the permanence of the mechanism, the term of the liquidity guarantee contract shall be at least one year. The contract shall include a provision requiring that it be renegotiated at least one year before its date of termination.

#### 2.3.4. What happens when the guarantee concerns a specified amount?

The mechanism shall propose liquidity equivalent to that which the fund would enjoy if it held at least one-third of liquid securities.

To ensure that the guarantee covers one-third of the fund's assets at all times, the AMF has defined rules which are described in Article 30-10 of Instruction DOC- 2011-21. Accordingly, if the liquidity agreement concerns a predefined amount, that amount must initially represent at least 50% of the fund's assets and the contract must include a provision requiring that it be renegotiated whenever that amount represents only 35% of the fund's assets.

In the event of the combination of the first two methods mentioned in Article L. 3332-17 of the French Labour Code, namely liquid securities in the fund's assets and a liquidity guarantee mechanism covering the difference between the required third and the percentage of liquid securities held by the fund, the guarantee agreement may also cover a defined amount. The due diligence described above shall in that case be applicable in proportion to the fraction covered. In that case the agreement shall also include a provision for renegotiation when the percentage of liquid securities and the percentage guaranteed by the fund might no longer be able to cover one-third of the fund's assets.

It is also possible that the guarantee agreement may contain a monitoring provision to ensure the readjustment of the guaranteed amount at all times ("top-up clause"), so as to ensure that the latter corresponds to at least one-third of the fund's assets.

#### 2.3.5. In what case must the guarantor have a counter-guarantee?

The guarantor must have a counter-guarantee when the guarantee is not insured by a credit institution or an insurance company, in accordance with articles R. 214-214 of the Monetary and Financial Code and 424-8 of the AMF General Regulation.

#### 2.3.6. What are the conditions of the counter-guarantee?

They are defined in Article 424-8 of the AMF General Regulation.

The counter-guarantee may take the following forms:

- A performance guarantee from a credit institution whose head office is located in an OECD Member State, or from an insurance company or an investment firm<sup>11</sup> whose head office is located in a European Union Member State or another State that is a party to the Agreement on the European Economic Area;
- A line of credit granted by a credit institution whose head office is located in an OECD Member State, and allocated to execution of the commitment;
- A portfolio of liquid securities within the meaning of Article R. 214-214 of the Monetary and Financial Code, pledged on behalf of the management company of the employee investment undertaking or the SICAV for employee savings.

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<sup>11</sup> It must be authorised to provide the service mentioned in point 1 of Article L. 321-2 of the Monetary and Financial Code and must have an amount of capital at least equal to EUR 3.8 million within the meaning of Directive 2000/12/EC of 20 March 2000.

These various methods can be combined.

Since the counter-guarantee is expected to permit execution of the guarantee in the event of a default by the guarantor, its operating procedures, amount and term must be at least equivalent to the conditions appearing in the guarantee contract.

## **2.4. Mechanism 3: Commitment by the company to buy back its own securities**

2.4.1. Can the commitment to buy back the company's securities held in the employee investment undertaking be made by the company's parent company?

Yes, in accordance with Article L. 3332-17 of the French Labour Code, the company's parent company can commit itself to buy back the company's securities. In that case, the buyback limit of 10% of the registered capital is applicable in value terms to the capital of the parent company bound by the commitment.

2.4.2. Can the commitment to buy back the company's securities held in the employee investment undertaking be made by a subsidiary of the company?

Yes, in accordance with Article L. 3332-17 of the French Labour Code, a subsidiary of the company can commit itself to buy back the company's securities. In that case, the buyback limit of 10% of the registered capital is applicable to the value of the capital of the subsidiary bound by the commitment.

2.4.3. What are the conditions of application of the commitment to buy back the company's securities?

The last paragraph of Article L. 225-209 of the French Commercial Code refers to the general conditions of the commitment to buy back its own securities applicable to public limited companies, partnerships limited by shares and simplified joint-stock companies.

2.4.4. What regime can apply to an employee investment undertaking invested in the company's unlisted securities benefiting from a commitment to buy back its own securities by the company or by a company in the group?

Due to the commitment to buy back securities by the company or a company in the group, the employee investment undertaking invested in the company's unlisted securities not admitted for trading on a regulated market enjoys a so-called "simplified" regime covered by the provisions of Article L. 3332-17 of the French Labour Code.

This simplified regime comprises:

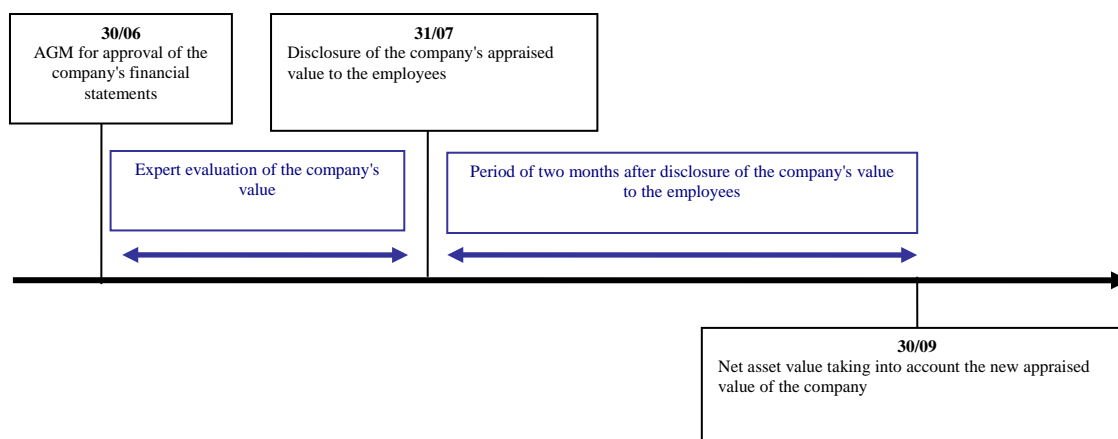
- on the one hand, an obligation for the company to disclose the appraised value to its employees at least two (2) months prior to publication of the net asset value of the employee investment undertaking, taking into account said appraised value of the company, and this for each net asset value publication; and
- on the other hand, a frequency of calculation of the net asset value which is at least once a year and at most once each quarter (Article 424-15 of the AMF General Regulation).

2.4.5. What are the stages in establishing the simplified regime for employee investment undertakings invested in the company's unlisted securities?

Taking the example of an employee investment undertaking benefiting from a commitment by the company to buy back its own securities, the timeline for establishing the scheme based on a calendar year comprises the stages described below:

- Close of the accounts: the company's annual financial statements are approved by the company's annual general meeting which shall be held on 30 June at the latest, for those companies whose financial year ends on 31 December of each year.
- Establishment of the company's valuation by an expert: an expert evaluation of the company's value will be made following the closure of the accounts.
- Obligation for the company to disclose the appraised value to the employees. Pursuant to Article L. 3332-19 of the French Labour Code, the information shall be disclosed by the company to all the employees individually. It shall include, in addition to the appraised value of the company, the change in the appraised value by comparison with the previous value reported, the date of publication of the next net asset value of the fund which shall take into account this new appraised value, and the contact details of the custodian/account-keeper to which the employees may make their request for subscription, arbitrage or buyback of their assets. The custodian/account-keeper and the supervisory board shall be informed by the company of its appraised value.

The timeline for establishing the scheme is as follows:



2.4.6. What happens at the end of the period of authorisation given by the general meeting of the shareholders to buy back its own securities?

Upon the expiry of this period, the company is banned from buying back its own securities. Therefore, the management company should make sure that before the expiry of the authorisation given by the general meeting for the company to buy back its own securities, the company takes measures for either:

- a renewal of the general meeting's decision to authorise the company's buyback of its own securities;
- the adoption, at the end of the term of authorisation, of another liquidity system (e.g. a liquidity guarantee mechanism).

2.4.7. What are the consequences if the general meeting of the shareholders does not renew the authorisation given to the company to buy back its own securities?

The calling into question of the liquidity mechanism due to the general meeting's failure to renew the authorisation for the company to buy back its own securities means calling into question the simplified regime



and, as a consequence, the frequency of calculation of the net asset value, which is at least once a year in the simplified regime.

In any case, the rules or articles of association of the employee investment undertaking should anticipate this situation by providing for the system to be established in order to rectify it (case of early winding up of the employee investment undertaking, transformation into a "conventional" employee investment undertaking invested in the company's unlisted securities, etc.).

As a reminder, as manager of the employee investment undertaking, the management company must ensure that a liquidity mechanism is active at all times at the employee investment undertaking level.

2.4.8. What are the procedures for transforming an existing employee investment undertaking into an employee investment undertaking benefitting from the simplified regime?

Any change in the liquidity mechanism of the employee investment undertaking (notably a switch from the one-third liquid rule to a liquidity guarantee mechanism) is subject to authorisation, in accordance with the provisions of AMF Instruction DOC-2011-21.

It should be specified that the transformation of an existing employee investment undertaking into an employee investment undertaking benefitting from the simplified regime implies carrying out the following steps:

- Approval by the general meeting of the company's shareholders of the commitment to buy back its own securities within the limit of 10% of its registered capital (commitment to buyback at first demand);
- To the extent that the rules of the employee investment undertaking so require: the prior agreement of the employee investment undertaking's supervisory board for the change of liquidity mechanism;
- Authorisation of the AMF;
- Appropriate notification of unitholders;
- Coming into effect of the transformation implying updating of the company's valuation.

2.4.9. What are the procedures for transforming an employee investment undertaking benefitting from a simplified regime into a "conventional" employee investment undertaking invested in the company's unlisted securities?

The transformation of an employee investment undertaking benefitting from a simplified regime into a "conventional" employee investment undertaking invested in the company's unlisted securities is subject to an authorisation of the AMF, and the unitholders shall be given appropriate notification before it comes into effect. It requires a change of liquidity mechanism.

## 2.5. Valuation of securities

2.5.1. What are the methods for valuation of securities and who determines the method?

The method for valuation of the company's securities is determined at least every five years by an independent expert. The expert must define a new method of valuation in the event of a substantial change in the company's business, or when an exceptional change in its situation has occurred.

The independent expert may opt for a "multiple-criterion valuation method". Otherwise, the company's securities are valued by the "revalued net assets method".<sup>12</sup>

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<sup>12</sup> Article L. 3332-20 of the French Labour Code

- Multiple-criterion valuation method:

Based on an appropriate weighting for each case, the multiple-criterion valuation method takes into account the company's net book value, profitability and business outlook. These criteria are assessed, where applicable, on a consolidated basis, or otherwise taking into account the financial information coming from significant subsidiaries.<sup>13</sup>

Some companies consider that it is insufficient to have the valuation method determined every five years by an independent expert. They therefore provide for the additional contribution of a body of independent experts which adjusts the appropriate weightings each year to the criteria within the limits set by the methodology. The contribution of the body of independent experts is not considered by the AMF as a change of method so long as the body states its opinion solely on the weightings and within the limits set in Article 8 of AMF Instruction DOC-2011-21.

- Revalued net assets method:

The company's securities are valued by dividing the amount of the revalued net assets based on the most recent balance sheet by the number of outstanding securities. The revalued net assets are therefore determined for each financial year under the supervision of the auditor.<sup>14</sup>

The use of an independent expert every five years is optional for companies employing less than 500 employees which, from the third financial year ended after the date of issue of the securities offered to the employees, opt for the revalued net assets method.

#### 2.5.2. Who values the securities and with what frequency?

The securities are valued by the company, under the supervision of the auditor, at least once each financial year and whenever an event or a series of events occurring during a financial year could lead to a substantial change in the value of the company's shares.<sup>15</sup>

In addition, the company's securities are valued every five years<sup>16</sup> by the independent expert, generally at the same time as the latter determines the valuation method.

Valuation every five years by an independent expert is optional in companies employing less than 500 employees which, from the third financial year ended after the date of issue of the securities offered to the employees, opt for the revalued net assets method.<sup>17</sup>

#### 2.5.3. Who is responsible for appointing the independent expert?

The company is responsible for appointing the independent expert, in accordance with D. 3324-20 and R. 3332-23 of the French Labour Code.

## 2.6. Articles of association and shareholder pact

2.6.1. Is it possible for an issuing company to have in its articles of association provisions enabling it to control the sale of securities?

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<sup>13</sup> Article L. 3332-20 of the French Labour Code, paragraph 1

<sup>14</sup> Article L. 3332-20 of the French Labour Code, paragraph 2

<sup>15</sup> Article R. 3332-23 of the French Labour Code

<sup>16</sup> Article R. 3332-23 of the French Labour Code

<sup>17</sup> Article R. 3332-23 of the French Labour Code

It is possible to insert in the articles of association of the issuing company pre-emption or authorisation provisions aimed at controlling the transfer of the company's capital to third parties. However, these provisions must not adversely affect the liquidity of the securities. In order to comply with the deadline for payment of the units bought from the holder,<sup>18</sup> the maximum length of the process of authorisation of the sale or pre-emption of securities must not be greater than one month.

2.6.2. Can an employee investment undertaking invested in the company's unlisted securities be party to a shareholder pact?

Subject to the sovereign judgment of the courts, a distinction should be made between two situations:

- Either the company whose securities are not admitted for trading on a regulated French market or on a regulated European market or on a recognised regulated market (outside the EEA) does not belong to a group; in that case, the employee investment undertaking invested in the company's unlisted securities may be party to a shareholder pact;
- Or the company whose securities are held in the portfolio of the employee investment undertaking belongs to a group; in that case, the employee investment undertaking invested in unlisted securities may be party to a shareholder pact only provided that none of the group's companies has issued securities listed on a regulated French market or on a regulated European market or on a recognised regulated market (outside the EEA).

Accordingly, in order to determine whether an employee investment undertaking invested in unlisted securities can sign a shareholder pact, it should first be checked that the group to which the company in question belongs does not include a company whose securities are listed on a market, including foreign markets.

2.6.3. Can an employee investment undertaking invested in the company's listed securities be party to a shareholder pact?

No, only employee investment undertakings invested in the company's unlisted securities can be party to a shareholder pact.

2.6.4. What are the objectives to be pursued by a shareholder pact signed by an employee investment undertaking invested in unlisted securities?

In accordance with the provisions of Title IV of Article L. 214-165 of the Monetary and Financial Code, the shareholder pact should promote the transfer of the company, the stability of the share ownership structure or the liquidity of the fund.

2.6.5. Who is authorised to be party to a shareholder pact in the name and on behalf of the employee investment fund?

Pursuant to Article L. 214-24-42<sup>19</sup> of the Monetary and Financial Code, since the employee investment fund does not have a legal personality, only the management company is authorised to sign the shareholder pact in the name and on behalf of the fund, following approval by the employee investment fund's supervisory board, if the rules of the employee investment fund so provide (see 2.6.10 of the present position).

2.6.6. Can an employee investment undertaking invested in the company's unlisted securities, during its life, become party to a shareholder pact?

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<sup>18</sup> Payment of the units bought from the holder must be performed within a maximum period of one month. This period runs from the date of calculation of the per-unit value on the basis of which the purchase application was made.

<sup>19</sup> Article L. 214-24-42 of the Monetary and Financial Code is applicable to retail investment funds and is also applicable to employee investment undertakings referred to by Article L. 214-163 of the Monetary and Financial Code.

Yes, an employee investment undertaking invested in the company's unlisted securities can, during its life, become party to a shareholder pact, provided that it complies with the conditions mentioned notably in Title IV of Article L. 214-165 of the Monetary and Financial Code (cf. question 2.6.2).

2.6.7. Must the provisions appearing in shareholder pacts comply with the liquidity requirements governing employee investment undertakings?

Yes, the content of a shareholder pact signed by an employee investment undertaking invested in the company's unlisted securities must be compatible with the requirements imposed on the fund, and notably the liquidity requirement. For example, the commitment to hold the securities for a certain period of time, known as the *lock-up provision*, often provided for in the case of an initial public offering, must not prevent the employee investment undertaking from reimbursing those unitholders who so request, either out of their available assets or out of their assets becoming available as a result of a case of early unlocking.

2.6.8. What are the procedures for notification of the AMF in the event of the signature of a shareholder pact during the life of the employee investment undertaking invested in the company's unlisted securities?

The signature of a shareholder pact by an employee investment undertaking, after its formation, is not subject to authorisation provided that it does not give rise to other expected changes. However, this signature requires notification of the AMF in the form of a declaration. Updating of the GECO database shall be performed by sending the rules duly amended.

2.6.9. How are the unitholders informed of the signature of the shareholder pact?

A distinction should be made between two situations:

- If the employee investment undertaking invested in the company's unlisted securities is currently being created, the information concerning the existence of a shareholder pact must appear in the rules;
- If the employee investment undertaking invested in the company's unlisted securities already exists, in addition to the amendment of the rules, the information shall be provided by all means and ex-post.

### **Recommendation**

**When the commitments made by the shareholder pact are liable to significantly influence the employee investment undertaking, it is recommended to prefer personal notification of the unitholders.**

2.6.10. To what extent should the supervisory board take part in the signature of a shareholder pact?

In accordance with Article L. 214-165 of the Monetary and Financial Code, the supervisory board "decides on mergers, split-ups and liquidations. The rules of the employee investment fund specify what are the changes to the rules that cannot be decided on without the approval of the supervisory board".

Accordingly, whenever the transformations and changes resulting from the establishment of the shareholder pact are in principle within the power of decision of the supervisory board or, under the terms of the employee investment fund's rules, require the approval of the supervisory board:

- If the employee investment fund already exists, the signature of the shareholder pact itself must be submitted for the prior approval of the supervisory board;
- If the employee investment fund is currently being created, the AMF recommends providing for the establishment of the supervisory board before the signature of the shareholder pact. Otherwise, as soon as it is formed, the supervisory board is informed of the content of the shareholder pact.

### **Recommendation**

**When the commitments made by the employee investment fund in the shareholder pact are not within the competence of the supervisory board, it is nevertheless recommended to systematically inform the latter of the signature of the pact or its amendment in order to enable the members of the supervisory board to know the commitments made by the employee investment fund.**

2.6.11. What are the points to watch that the management company is required to check?

The management company makes sure that the provisions of the shareholder pact are properly in compliance with the specific regulations on employee investment undertakings and notably with the objectives defined in the last paragraph of Article L. 214-165 of the Monetary and Financial Code.

In particular, it is up to the management company to make sure that the price definition provision appearing in the shareholder pact complies with the provisions of articles L. 3332-19 to L. 3332-24 and R. 3332-22 and R. 3332-23 of the French Labour Code stipulating the procedures for evaluation of the selling price of securities issued by the company, and in particular the valuation of the securities by a valuation method defined by an independent expert.

Likewise, if the company's securities are admitted for trading on a regulated market, the employee investment undertaking cannot undertake to ensure the liquidity of the securities on the market. Management companies must take care when drawing up this type of initial public offering clause:

- either by adapting these stipulations to the operating procedures of the employee investment undertaking;
- or by excluding the employee investment undertaking from the scope of application of such a clause.

## **2.7. Investment in securities having an asymmetric risk/return profile**

When an employee investment undertaking invests in securities (ordinary shares, preference shares, convertible bonds, plain vanilla bonds, etc.) having an asymmetric risk/return profile,<sup>20</sup> the legal documentation and, where applicable, the employee investment fund's information brochure, must enable unitholders to properly understand the specific features of the fund. For this purpose, several scenarios may, for example, be presented to illustrate the specific features of the employee investment undertaking.

## **2.8. The employee buyout fund**

2.8.1. Can an employee investment undertaking invested in the company's unlisted securities host a company buyout operation reserved for certain employees?

Yes, Article L. 3332-16 of the French Labour Code provides for another type of employee investment undertaking invested in the company's unlisted securities, dedicated to a buyout operation on the company's securities or securities of a company in the same group within the meaning of paragraph 2 of Article L. 3344-1 of the French Labour Code, or on those of a holding company set up with a view to its acquisition reserved for employees. This type of employee investment undertaking is called an "employee buyout fund".

2.8.2. Must an employee buyout fund be backed up by a company savings plan?

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<sup>20</sup>This also applies to any clause in shareholder pacts or provision in the articles of association that could have the same effects in terms of the risk/return profile.

Yes, in accordance with Article L. 3332-16 of the French Labour Code, the employee buyout fund must be backed up by a negotiated company savings plan.

#### 2.8.3. What are the procedures for the creation of an employee buyout fund?

Like for any employee investment undertaking, the formation of an employee buyout fund is subject to authorisation. At the time of its formation, pursuant to Article L. 3332-16 of the French Labour Code, the management company shall have documents justifying the prerequisite conditions for formation:

- A negotiated company savings plan providing for the existence of the employee buyout fund;
- The minimum number of employees taking part in the buyout reserved for employees is at least 15 employees or at least 30% of the employees for companies with no more than 50 employees;
- An agreement with the personnel containing the following mandatory information:
  - o Identity of the employees taking part in the buyout;
  - o The final control structure; and
  - o Completion of the transaction.

#### 2.8.4. What are the investment rules applicable to employee buyout funds?

In accordance with Article L. 3332-16 of the French Labour Code, the employee buyout fund has special investment rules. It can invest 95% of its assets in the company's securities or in securities of a company in the same group within the meaning of paragraph 2 of Article L. 3344-1 of the French Labour Code, or in those of a holding company set up with a view to acquisition of the company.

#### 2.8.5. Does there exist a liquidity mechanism applicable to employee buyout funds?

Yes, the employee buyout fund has a liquidity mechanism derogating from those applicable to employee investment undertakings invested in the company's unlisted securities. It must contain liquid securities representing at least 5% of its assets.

#### 2.8.6. What is the procedure for appointing the members of the supervisory board of an employee buyout fund?

In accordance with Article L. 3332-16 of the French Labour Code, and as an exception to the employee investment funds covered by Article L. 214-165 of the Monetary and Financial Code, the members of the supervisory board of an employee buyout fund are elected by all employees who are unitholders.

#### 2.8.7. Can an employee buyout fund be party to a shareholder pact?

Yes, and employee buyout fund can be party to a shareholder pact provided that it comply with the conditions mentioned in the last paragraph of Article L. 214-165 of the Monetary and Financial Code (cf. question 2.6.2).

#### 2.8.8. For how long are the amounts paid by employees into an employee buyout fund locked in?

The provisions of Article L. 3332-16 of the French Labour Code state that the amounts and the securities are locked in until completion of the company's buyout by the employees, but this holding period may not be less than five years.

#### 2.8.9. Are there cases of early unlocking applicable to employee buyout funds?

Yes, Article R. 3332-29 of the French Labour Code provides for three exceptional cases of early unlocking applicable to employee buyout funds:

- Disability of the employee, assessed in accordance with 2° and 3° of Article L. 341-4 of the French Social Security Code;
- The employee's retirement;
- The employee's death.

### 3. LEVERAGED EMPLOYEE INVESTMENT UNDERTAKINGS

An employee investment undertaking coming under the formula fund classification aims to achieve as its management objective, by the end of a defined period, an amount determined by the mechanical application of a predefined calculation formula, based on market indications or financial instruments, and to distribute, where applicable, income determined in the same way.<sup>21</sup>

In return for the described commitment, the achievement of the management objective must be guaranteed by a person mentioned in Title II of Article R. 214-32-28 of the Monetary and Financial Code, i.e. by an institution having the capacity of UCITS depositary, a credit institution whose head office is established in an OECD Member State, or an insurance company or an investment firm whose head office is established in a European Union Member State or another State that is a party to the Agreement on the European Economic Area and which is authorised to provide the service mentioned in point 1 of Article L. 321-2 and the amount of whose capital, within the meaning of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, is at least equal to EUR 3.8 million. The guarantee can be granted to the fund or to its unitholders or shareholders. The consideration for the guarantee, borne by the subscribers (generally by waiving the discount, dividends, tax credits and a share of performance) must appear explicitly in the Key Investor Information Document and the rules.

Leveraged employee investment undertakings are formula funds whose specific feature is to offer a performance indexed on that of the securities of a company in particular.

Queried by several professionals during the investigation of these products, the Autorité des Marchés Financiers wants to recap or clarify the rules applicable to these funds

#### **3.1. Market movements and notification of the public upon the creation or closure of a leveraged employee investment undertaking**

Upon the creation of a leveraged employee investment undertaking invested in the company's securities, the counterparty may have to short the issuer's securities in order to hedge its commitments to the employee investment undertaking.

This possible operation must take place in accordance with the legislative and regulatory provisions in force.

Moreover, upon the closure of a leveraged employee investment undertaking invested in the company's securities, the sale of those securities by the management company is liable to have an impact on the market.

The Autorité des Marchés Financiers reminds:

- management companies and counterparties to swap transactions:

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<sup>21</sup> Article 30-9 of AMF Instruction DOC-2011-21 relating to authorisation procedures, preparation of a KIID and a prospectus and periodic reporting for employee investment undertakings.

- that they are bound by the obligation not to disrupt the market, in accordance with Book VI of the AMF General Regulation and, in the case of asset management companies, with Article 321-100<sup>22</sup> of the AMF General Regulation, providing for an obligation to act in an honest, loyal and professional manner, with the required competence, care and diligence, in order to serve clients' interests as well as possible and foster market integrity;
  - that it is therefore necessary to take this obligation into account in the structuring of transactions and that, in this respect, the unwinding of employee investment undertakings on the basis of an averaged price should make it easier to comply with these provisions;
  - that if the management company does not wish to use a liquidity mechanism, it must be able to provide justification of the measures taken to comply with this article;
- companies issuing the underlying securities of leveraged employee investment undertakings that they must, in accordance with Article 223-2 of the AMF General Regulation, provide the public by a news release for which they ensure its effective complete dissemination:
- during the period between the date of the meeting of the statutory corporate body which determines the date of the capital increase and the start of the reservation period, and in all cases before the start of the hedging transactions of the counterparty to the swap contract, with appropriate information concerning the existence of these transactions. This information shall, in particular, concern the maximum number of shares that could be created, the dates of the transactions and the existence of a leverage effect that could result in hedging operations. The information given to the public shall also include an indication of the conditions of exercise of voting rights pertaining to the securities issued for the intermediary for leverage requirements;
  - before the close of the transaction, i.e. before the sale of the securities on the market by the employee investment undertaking, appropriate information concerning the unwinding of the transaction and on the possibility of impacting the market for the security. However, this second information is not necessary when unwinding of the transaction takes place off-market due, for example, to the existence of a liquidity mechanism (see below).

### **3.2. Information for unitholders**

Leveraged employee investment undertakings can be likened to formula funds to the extent that the unitholders take their investment decision according to the formula proposed by the fund manager, and not according to the nature of the investment management during the fund's life.

Regarding this, these funds are required to comply with Article 30-9 of AMF Instruction DOC-2011-21 relating to authorisation procedures, preparation of a KIID and a prospectus and periodic reporting for employee investment undertakings.

### **3.3. Guarantee of the formula**

In accordance with the provisions stipulated for formula funds, the guarantee linked with leveraged employee investment undertakings concerns the entire formula. Accordingly, when the formula includes both capital protection and a share in the performance of the company's securities, these two components are covered by a guarantee, except in the exceptional cases stipulated in section 3.4 of this document.

### **3.4. Particular provisions of the swap contract or guarantee contract**

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<sup>22</sup> or Article 319-3 for asset management companies coming under Title Ier bis of Book III of the AMF General Regulation.



The formula proposed by the fund may be adjusted or even called into question in certain cases, provided for in the swap contract and symmetrically in the guarantee contract.

Some of these cases are classic and the resulting formula adjustments are legitimate: non-dilutive events (stock split, takeover bid, public exchange offer, etc.), dilutive events (capital increase with rights, exceptional dividend, etc.), events affecting the fund's assets (change in the tax environment, such as, for example, a withholding tax applicable to swap flows, etc.).

Others are more difficult, such as provisions designed to allow the counterparty to terminate or adjust the contract if the cost of hedging the contract becomes excessive. Such a situation could, for example, arise if the cost of borrowing the company's securities increases, the swap contract counterparty being structurally a borrower of the company's securities.

For this reason it should be remembered that:

- the use of provisions allowing performance adjustments related to events affecting swap hedging management assumes, in particular, that the conditions in which these provisions can be acted on are defined objectively (e.g., identification of the criteria used to assess the counterparty's hedging difficulties);
- and in any case, the early termination of the swap contract by the counterparty cannot entail calling into question the fixed component of the formula: for example, a fund which offered 90% capital protection in the event of an early exit could not see that protection called into question in the event of an early termination of the swap contract by the counterparty.

### **3.5. Refusal of a leveraged employee investment undertaking arrangement involving the issuer as party to the underlying hedge and the use of long-term derivatives as part of a share buyback programme**

In a case submitted to the regulator, a company wanted to set up a leveraged employee investment undertaking with a five-year term proposing a guarantee on the capital invested by the employee and on part of the stock's performance above a reference price. This guarantee was to be provided by the asset management company managing the employee investment undertaking.

Management of the arrangement involved the asset management company making a forward purchase of all the shares subscribed to by the employee investment undertaking and a sale of call options at the money to the employee investment undertaking to be able to guarantee the stock's performance. The forward purchase made it possible to guarantee their personal investment for the employees and to repay the financing for the capital increase, via a swap transaction carried out between the employee investment undertaking and the asset management company.

The bank proposed establishing two hedging procedures:

- To partially hedge the forward purchase, an over-the-counter sale of these securities in the cash market to a counterparty at the reference price. This sale of securities in the cash market was covered by the asset management company by borrowing securities for a five-year term partly from the issuer, since the low liquidity of the market for the security made such transactions impossible;
- In order to cover the balance of the forward purchase transaction, this sale in the cash market was supplemented by either:
  - i) A sale of share put options by the issuer to the asset management company covering the latter in the event that the call options granted to the employee investment undertaking were still out of the money at the end of the programme. The strike date of the option coincided with that of the employee

transaction and an early termination clause was stipulated in the event of non-renewal of the share buyback programme;

ii) A cash purchase and a sale of call options by the issuer to the asset management company maturing in five years. If the share price at the maturity date was higher than the reference price, the bank had to pre-sell part of the securities during the six months before unwinding the employee investment undertaking, this short selling being covered by exercise of the call on the company.

Here again, given the limited market liquidity for the issuer's stock, the conventional hedging mechanism by which the asset management company buys shares in the market and makes the necessary adjustments during the life of the transaction for "delta neutral" management of its position could not be adopted.

The proposed arrangement was refused on the grounds that:

a) It caused the issuer to run a risk, for no other reason than to ensure coverage for the bank because of its inability to manage this risk in a relatively illiquid market.

b) By itself performing hedging of the underlying transactions, the issuer thereby made the existing shareholders incur a cost on top of the authorised costs governed by the French Commercial Code (the maximum 20% discount to market prices, the charges resulting from the loan granted to employees for acquisition of the securities and the employer's contribution), and the specific situation of the employees as established by law did not justify the inequality of treatment between shareholders entailed by this additional cost.

c) Regarding the first hedging case, this hedging mechanism was incompatible with the rules laid down by the Commission relating to the conclusion of options transactions by an issuer on its own securities.<sup>23</sup> The Commission specified that put options could be granted by a company on its own securities whenever, among other requirements, the strike date of the options is not subsequent to the completion of the buyout programme decided on by the issuer.

d) Regarding the second hedging case, it could be considered that a purchase by the company on the cash market accompanied by a sale of call options on its own shares was similar to a synthetic sale of put options.

e) In the second hedging case, by buying the securities for the planned transaction from the asset management company on the cash market at the start of the transaction, the issuer financed in cash part of the reserved capital increase for its employees (already benefitting from a 20% discount to the reference price and a 90% leverage effect) and covered the bank for part of the risk resulting from its forward purchase of the securities. The transaction therefore appeared partially fictitious because, economically, the issuer had to immediately buy back part of the securities issued. It should also be noted that the financing and sale of call options offered to the employees can be analysed as stock options for which a legal framework already exists.

### **Recommendation**

**It is recommended that companies which have securities that are not very liquid should adapt the size and characteristics of the leveraged employee investment undertaking's transactions so that the underlying hedging transactions may always be taken charge of by the asset management companies, and not by the issuer.**

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<sup>23</sup> Monthly Bulletin 332 of February 1999.

#### 4. DUE DILIGENCE TO BE CONDUCTED FOR DRAFTING AN OFFICIAL REPORT OF FAILURE TO ATTEND FOR AN EMPLOYEE INVESTMENT UNDERTAKING

In accordance with Article 37 of AMF Instruction DOC-2011-21 relating to employee investment funds, *"the supervisory board shall meet at least once a year for the adoption of its annual report [...]. Together with the company, the management company and the depositary shall ensure compliance with this obligation. If the supervisory board is unable to meet on second call, the management company shall draft an official report of failure to attend."*

##### **Recommendation**

<p><b>It is good practice for the management company, before the official report of failure to attend is drafted, to inform the company of the follow-up measures that it plans to take for management of the fund.</b></p>
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For example, if the supervisory board of an employee investment fund has been unable to meet and if the management company decides to have that fund taken over by a "multi-company" fund for which it also performs management, the management company shall inform the company of this plan and subsequently draw up an official report of failure to attend.