

Equity Derivatives

in France

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OVERVIEW

Typical types of transactions

Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

The market for OTC derivatives transactions in France is well established and equity derivative products are routinely used in the implementation of stake-building transactions, equity price risk hedging strategies and share repurchase schemes.

Typical equity derivatives products used by issuers on the French market include (but are not limited to):

- call options, put options and total return swaps to hedge equity price risks on a bespoke basis;
- funded collar in the context of the leveraged acquisition of a stake in a publicly listed company involving an embedded hedge to the market price of the equity purchase (often on a tranching basis);
- unfunded collar in the context of the disposal of a stake in a publicly listed company involving an embedded hedge to the market price of the equity disposal (often on a tranching basis);
- prepaid equity forward in the context of share buy-backs involving a forward transaction that is settled on the basis of the discounted volume-weighted average price of the shares over a certain period (often to hedge a share employee participation scheme);
- accelerated share buy-backs with guaranteed discount in the context of share buy-backs involving the immediate delivery of shares at a discount with a future adjustment based on the volume-weighted average price of the shares over a certain period;
- contingent prepaid forward allowing for the prepayment and purchase of shares being delivered only subject to certain contingencies occurring (ie, regulatory approvals); and
- call spread to hedge certain features of exchangeable bonds.

Margin loans are not widely used on the French market to finance or leverage large shareholdings. This is essentially due to the idiosyncrasies of the transposition of Directive (EU) No. 2002/47/EC of 6 June 2002 on financial collateral arrangements under French law, which has created, in respect of margin loans, uncertainty in the enforcement of the security interest against an insolvent French borrower (as the enforcement process may be potentially affected or limited by the opening of insolvency proceedings in France).

Borrowing and selling shares

May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

Yes. The French rules on short selling are derived from Regulation (EU) 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (these rules are therefore applicable across all EU member states for all EU-listed shares unless they are primarily traded on a third-country venue). Naked short selling is prohibited in France, and market participants can only create short positions in shares on the French market if they own or have borrowed the relevant shares or have entered into an agreement with a third party, providing reasonable assurances that the shares will be delivered.

Any natural or legal person that holds a short position equal to or higher than 0.2 per cent of the share capital of a company whose shares are admitted to trading on a French trading venue must notify the French regulator (the

Financial Markets Authority (AMF)) of this position within one trading day (and of each movement through a 0.1 per cent threshold above 0.2 per cent). When the net short position reaches or falls below 0.5 per cent of the share capital, the AMF will publicly disclose the information. In exceptional circumstances (such as in the opening Lehman bankruptcy proceedings or the covid-19 crisis), the AMF has the power to decide to temporarily restrict short selling in case of a significant fall in the price of financial instruments on a given day (a 10 per cent drop for liquid shares, a 20 per cent drop for illiquid shares when the share price is higher than €0.50 and a 40 per cent drop when share price is below €0.50).

Applicable laws and regulations for dealers

Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

There is no single body of rules regulating equity derivatives in France. Dealers, as financial counterparties subject to licensing requirements, are generally subject to all the rules and regulations affecting the treatment of derivatives (including equity derivatives). These rules affect various aspects of the life cycle of equity derivative transactions.

We note, in particular, the applicability of the following rules (this list is not exhaustive) pertaining to:

- financial netting: France has implemented Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements in its Financial and Monetary Code, which introduced derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) that are applicable to derivatives transactions entered into between dealers if certain conditions are met. In particular, the Financial Netting Regime allows counterparties to implement the close-out netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings;
- threshold crossing: market participants (when they cannot make use of the bank trading exemption) need to comply with the relevant provisions of the French Commercial Code and the General Regulations of the French Financial Market Authority relating to the filing of disclosure threshold notifications by the close of trading on the fourth trading day following the acquisition or disposal of a significant holding, including when these exposures are created through forward financial instruments (either cash or physically settled);
- market abuse: market participants are subject to Regulation (EU) 596/2014 (MAR) on market abuse containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation, which all need to be considered in the context of equity derivative transactions (especially where persons discharging managerial responsibilities within issuers, and persons closely associated with them, are involved);
- market infrastructure: market participants are subject to Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), which imposes risk-reducing or transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (clearing through central counterparties, reporting of transactions to trade repositories, risk mitigation techniques, etc);
- short selling: market participants are subject to Regulation (EU) 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps; and
- benchmark: market participants are subject to Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds.

The AMF is the authority primarily responsible for policing these rules in France.

Entities

In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

There are no general regulatory exclusions on the types of entities that may enter into OTC equity derivatives transactions in France. France has implemented the provisions relating to customer classification under the MiFIDII/MiFIR regulatory framework. OTC derivatives counterparties will benefit from a different level of protection depending on their regulatory classification (professional versus non-professional clients). Entities that enter into OTC equity derivatives transactions in France are mainly banks, credit institutions, financial services institutions, funds and large corporates.

Applicable laws and regulations for eligible counterparties

Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

The primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer are generally consistent with the following laws and regulations:

- financial netting: France has implemented Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements in its Financial and Monetary Code, which introduced derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) that are applicable to derivatives transactions entered into between dealers if certain conditions are met. In particular, the Financial Netting Regime allows counterparties to implement the close-out netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings;
- threshold crossing: market participants (when they cannot make use of the bank trading exemption) need to comply with the relevant provisions of the French Commercial Code and the General Regulations of the French Financial Market Authority relating to the filing of disclosure threshold notifications by the close of trading on the fourth trading day following the acquisition or disposal of a significant holding, including when these exposures are created through forward financial instruments (either cash or physically settled);
- market abuse: market participants are subject to the MAR, containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation, which all need to be considered in the context of equity derivative transactions (especially where persons discharging managerial responsibilities within issuers, and persons closely associated with them, are involved);
- market infrastructure: market participants are subject to EMIR, which imposes risk-reducing or transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (clearing through central counterparties, reporting of transactions to trade repositories, risk mitigation techniques, etc);
- short selling: market participants are subject to Regulation (EU) 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps; and
- benchmark: market participants are subject to Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds.

However, for certain types of counterparties that are regulated in France, French law imposes additional restrictions that will impact the entry into, or the treatment of, derivative positions (including equity derivatives). For example, with respect to insurance or reinsurance companies licensed in France, the French Insurance Code allows for entry into derivative instruments if these instruments contribute to reducing risks or improving the efficiency of the management of the portfolio of assets. Similarly, for certain collective investment schemes organised in France, derivative positions can only be entered into if their use is consistent with the strategy of the fund in question, and the derivative position can be terminated at any time (at market value or at a predetermined value) by the fund. The AMF is generally primarily responsible for administering these rules together with, in certain cases, the Prudential Control and Resolution Authority.

Securities registration issues

Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative?

No specific securities registration issues would arise in France as a result of the issuer of the underlying shares or an affiliate of the issuer selling the issuer's shares via an OTC equity derivative. In all instances, these transactions would be subject to compliance with the applicable provisions under the MAR relating to persons discharging managerial responsibilities, as well as persons closely associated with them.

Repurchasing shares

May issuers repurchase their shares directly or via a derivative?

Yes. French issuers may repurchase their own shares directly or indirectly via a physically settled OTC derivative within prescribed regulatory limits (French issuers are prohibited from holding more than 10 per cent of their own shares). If shares are repurchased via a derivative, it will typically be via an equity forward transaction contemplating the delivery by the dealer counterparty of a certain number of shares to the issuer at maturity, and calculated based on the volume weighted average price (often discounted) of the share over a certain period.

The following issues are typical of share repurchases via a derivative:

- the shareholders' authorisation taken in the context of the repurchase programme of the issuer must set out explicitly that share repurchases can be conducted via derivative instruments;
- the delivery of the shares being repurchased must not result in the issuer holding more than 10 per cent of its own shares, and the shares must be repurchased for one of the objectives stated in the share repurchase programme (ie, cancellation, hedging stock options or other share allocations granted to some or all eligible employees or executive officers, etc);
- share repurchases conducted via derivatives are not covered by the safe harbour provisions contemplated under the MAR and, therefore, do not benefit from the presumption relating to the absence of insider trading or market manipulation;
- share repurchases conducted via derivatives will generally need to be calibrated to follow the parameters of transactions eligible to fall within the safe harbour under the MAR (notwithstanding that these derivative transactions do not benefit from the safe harbour, counterparties will need to take precautions to ensure that they can demonstrate to the French regulator that relevant anti-abuse precautions have been taken); and
- issuers purchasing own shares via a derivative instrument will need to immediately inform the market (often via a press release) once they have concluded the derivative. They must also disclose, in that context, various items of information including the number of shares to be delivered, the maximum price and the period during which the

dealer will intervene on the market.

Risk

What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

Dealers with outstanding equity derivative positions with a bankrupt or insolvent French counterparty are, in much the same way as with other derivative positions, subject to the uncollateralised mark-to-market exposure resulting from the termination and close-out of these transactions. On the assumption that these outstanding equity derivative positions are documented under a market derivative framework agreement (a French Banking Federation (FBF) Master Agreement or an ISDA Master Agreement governed by French or English law), dealers facing an insolvent French counterparty will be able to terminate their outstanding derivative positions and calculate a net close-out balance owed by one party to the other under that contract and taking into account any amount of collateral previously posted (a net close-out debit or a net close-out credit).

In this context, dealers will be able to rely on the derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) introduced in the French Financial and Monetary Code following the implementation under French law of Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements. The Financial Netting Regime allows counterparties to implement the closeout netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings. The provisions of the Financial Netting Regime operate by exception to the general French insolvency regime. There are no specific applicable insolvency rules that would apply if the counterparty is the issuer or an affiliate of the issuer.

Reporting obligations

What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

Issuers are generally subject to the transaction reporting rules to trade repositories under EMIR.

In addition, shareholders entering into equity derivatives transactions on a French issuer's shares are required to file with the AMF and the issuer a disclosure threshold notification by the fourth trading day after reaching, exceeding or falling below 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, one-third, 50 per cent, two-thirds, 90 per cent and 95 per cent of the share capital of an issuer for which France is the home member state (under French law, this requirement is triggered at such percentage levels of both voting rights and of non-voting capital). Disclosure is needed where these thresholds are met from holding either shares with voting rights, financial instruments referencing shares with voting rights (entitlements to acquire and financial instruments with similar economic effect) or a combination of both. The notification by the shareholders shall include, inter alia, the total number of shares or voting rights they hold, the number of securities they hold that give deferred access to future shares and the voting rights attached thereto, and the shares already issued that they may acquire by virtue of the derivative instrument. When the underlying securities are effectively acquired, another notification will also need to be filed with the issuer and the AMF.

At the 10 per cent, 15 per cent, 20 per cent and 25 per cent levels, the shareholder's notification must include a statement of intent whereby the shareholder sets forth its intent with respect to the issuer during the coming six-month period. Any change in plans during such six-month period requires an amended filing (this disclosure must be made by the fifth trading day). Securities representing 5 per cent or less of an issuer's voting rights held within the trading book of a credit institution are exempt from these filing requirements, provided that the institution ensures that the voting

rights in respect of those shares are not exercised or otherwise used to intervene in the management of the issuer (this is commonly referred to as the 'trading exemption').

Issuers can also set separate disclosure thresholds in their articles of association, requiring shareholders to notify them when they cross these individual thresholds (which can be as low as 0.5 per cent).

Restricted periods

Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

There are no periods during which counterparties are specifically restricted from entering into OTC derivative transactions. However, the applicable rules relating to insider dealing and market abuse will apply to any counterparty to an OTC equity derivative transaction referencing shares admitted on a regulated market. In fact, the MAR sets out a prohibition on the ability of a counterparty to enter into a transaction (including an OTC equity derivative transaction) on the basis of inside information (information of a precise nature that is not publicly available and that would be likely to significantly impact the price of the shares if it were to be made available) or engage in the unlawful disclosure of inside information or market manipulation. If the counterparty to an OTC derivative transaction involving shares in an issuer is a 'person discharging managerial responsibility' in respect of that issuer, that person and any person closely associated with them must not deal in that issuer's securities during certain closed periods (30 calendar days before the announcement of an interim financial report or year-end report). In addition, while equity derivative instruments do not qualify for safe harbour under the MAR, if the equity derivative transaction involves a share buy-back of issuer shares under the share buy-back programme of the counterparty, the counterparties to the transaction will generally agree to not deal in the underlying shares during the closed periods.

Legal issues

What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

If a counterparty to an OTC equity derivatives transaction is also the issuer of the underlying shares, it will be constrained by the requirement imposed by French law that an issuer cannot hold more than 10 per cent of its own shares. Issuers entering into OTC equity derivatives transaction on their own shares will typically have to represent that the physical delivery of shares under the OTC equity derivative transaction will not entail a crossing of this 10 per cent threshold and, if it did, the transaction would have to be terminated. This is in addition to legal issues relating to market abuse. In particular, if a counterparty to an OTC equity derivatives transaction is also an affiliate of the issuer, it is often the case that issues relating to 'persons discharging managerial responsibilities' within issuers, and persons closely associated with them, have to be examined in the context of the applicability of market abuse regulations.

Tax issues

What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

French tax law provides for a specific corporate income tax regime applicable to equity derivatives that revolves around the recognition of latent capital gains or losses on such instruments (ie, mark-to-market taxation) and the possibility to

benefit from a tax roll-over regime on certain specific transactions. For all other aspects of French direct and indirect taxation, French tax law does not provide for specific rules but more general tax provisions may apply depending upon the means pursuant to which equity derivatives transactions are structured (eg, exercise of options, conversion or exchange of equity or debt instruments). Issues related to the characterisation of income and gains may also be triggered regarding the application of French withholding tax in the case of cross-border transactions. Consequently, a tax analysis generally needs to be conducted on a case-by-case basis.

In practice, counterparties to equity derivatives transactions will consider the timing of the physical delivery of the shares and the nature of the securities being transferred as collateral in the context of their potential tax implications (including the crystallisation of a gain or a loss at a particular point in time, the tax characterisation of this gain or loss and the possibility to benefit from a tax rollover regime under certain circumstances). In addition, as far as French indirect taxation is concerned, counterparties will generally explicitly address in the documentation the allocation of the payment of French transfer taxes or the French Financial Transaction Tax (when the shares are listed in France), irrespective of fallback indemnity provisions that may already be contained in the related derivative framework agreement.

Liability regime

Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

There is no specific liability regime applicable to OTC equity derivatives transactions. Counterparties to OTC equity derivatives transactions are subject to the general principles and mandatory rules of civil law liability arising under contracts (consent, certainty of object, legality of cause, absence of fraud) and to defined statutory offences governing, in particular, the provision of regulated investment services, market abuse and market manipulation, short selling, and compliance with applicable disclosure thresholds. These offences may, in some instances, give rise to criminal liability (in particular, in relation to insider dealing, unlawful disclosure, market manipulation, attempted market manipulation or the provision of regulated investment services in France without a proper licence).

Stock exchange filings

What stock exchange filings must be made in connection with OTC equity derivatives transactions?

There are no specific stock exchange filings that must be made in connection with OTC derivatives transactions under French law. However, some market stock exchanges have set out specific rules governing reporting obligations when trading on their derivative markets. For example, Euronext requires that Euronext derivative members report off order book transactions (eg, large-in-scale trades or some technical trades) to the relevant Euronext market undertaking (for Euronext Paris, within 15 minutes of the time at which the transaction was negotiated).

In addition, various filing requirements with the AMF and, potentially, the issuer, will arise in the event of the crossing of an ownership or voting rights threshold (under the French Commercial Code or the bylaws of the issuer), the build-up of a short selling position (under the Short Selling Regulation) or the involvement of persons discharging managerial responsibilities and persons closely associated with them (under the MAR). Also, in the context of a share buy-back, some issuers using equity derivative instruments have chosen, in addition to reporting share buy-back transactions to the AMF, to report to the competent authority of the trading venue on which the shares have been admitted to trading or are traded each transaction relating to the share buy-back programme (irrespective of the fact that these transactions do not fall within the safe harbour under the MAR).

Typical document types

What types of documents are typical in an OTC equity derivatives transaction?

OTC equity derivatives transactions are typically documented under a transaction confirmation forming part of either the FBF Master Agreement governed by French law or the ISDA Master Agreement governed by English or French law (a version of the ISDA Master Agreement governed by French law was published by ISDA in 2018 in the context of contingency planning for Brexit). Counterparties using the FBF Master Agreement and the ISDA Master Agreement governed by French law do, in much the same way as counterparties using the ISDA Master Agreement governed by English law, have the benefit of market legal opinions relating to the enforceability of close-out netting.

When using the FBF Master Agreement, parties will often incorporate the Share Option Technical Schedule published by the FBF, as well as additional relevant technical schedules for the transaction. The Share Option Technical Schedule contains a set of definitions used by counterparties in their equity derivative transactions (it is very high-level and counterparties often amend these definitions in the transaction confirmation to bring them closer in line with the 2002 ISDA Equity Derivative Definitions). When using the ISDA Master Agreement, parties will incorporate the 2002 ISDA Equity Derivatives Definitions. Although the 2002 ISDA Equity Derivatives Definitions were updated in 2011, French market participants rarely use the 2011 ISDA Equity Derivatives Definitions. Parties to OTC equity derivatives transactions may also be required to adhere to ISDA protocols or equivalent bilateral documentation for the purpose of complying with various regulatory requirements under EMIR.

When the equity derivatives transaction is a structured transaction, counterparties will often (but not always) document the transaction on the basis of a long-form confirmation (a standalone confirmation incorporating the terms of the relevant derivatives framework FBF or ISDA agreement) so as to ensure that the close-out netting set related that transaction with a particular dealer does not overlap with the close-out netting set under the derivative framework agreement used for the day-to-day treasury activities of the counterparty with that dealer.

Legal opinions

For what types of OTC equity derivatives transactions are legal opinions typically given?

If transactions are entered into under an ISDA Master Agreement or an FBF Master Agreement, parties will usually rely on the industry market opinions. However, these industry opinions cover only the enforceability of close-out netting in specific scenarios and, therefore, parties may agree on the need to provide legal opinions if there are specific enforceability issues in a given transaction. Similarly, legal opinions of capacity may be required when there are restrictions on the ability of a non-dealer counterparty to enter into derivative transactions.

Hedging activities

May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

An issuer may lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares subject to the share buy-back rules.

If the stock-lending or repurchase transaction involves a transfer of title to the counterparty, the issuer will repurchase its own shares at the maturity of the transaction. Therefore, the issuer will need to ensure that it complies with the 10 per cent restriction on the holding of own shares. A shareholder resolution will also be needed for the share buyback at maturity unless the shareholder resolution authorising the issuer's buyback programme is already in place and such

transactions fall under the programme. The title transfer of shares under a stock-lending or repurchase transaction may potentially trigger disclosure threshold notifications for the dealer counterparty unless an exemption is available.

As in other jurisdictions, stock-lending and repurchase transactions can raise market manipulation and market abuse issues. The return of shares upon the maturity of such transactions should comply with the MAR and guidance from the AMF on share buybacks (including, but not limited to, restrictions on transfers during closed periods). Repurchase transactions, securities lending and sell-buy back transactions qualify as securities financing transactions, and these transactions will likely be subject to reporting obligations under Regulation (EU) 2015/2365 of 25 November 2015 on transparency of security financing transactions and of reuse and amending Regulation (EU) 648/2012.

Securities registration

What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

If the shares are freely transferable, there are no specific securities registration requirements if a borrower pledges restricted or controlling shareholdings except for (if security is established via title transfer) the requirement to comply with applicable disclosure threshold obligations and, as the case may be, filing requirements set out under the MAR in case of the involvement of persons discharging managerial responsibilities and persons closely associated with them.

Borrower bankruptcy

If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

If a French corporate borrower in a margin loan files for bankruptcy protection, the lender will not be able to seize and sell shares provided as collateral and subject to a French pledge without potential interference from the French bankruptcy court or other creditors from the borrower.

This is because a margin loan does not qualify as an instrument eligible to the benefit of the Financial Netting Regime within the meaning of the French financial collateral arrangement rules resulting from the transposition into French law of Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements (at least not if only one of the parties is an eligible financial counterparty). As a result, as from the opening of an insolvency proceeding against a French corporate borrower, the pledge would be potentially subject to a stay of enforcement and, therefore, the lender may not be able to appropriate the collateral and apply it against debt owed to it under the margin loan without being potentially subject to a risk of stay.

As a consequence, a margin loan with a French borrower will typically be structured as a derivative under an ISDA or FBF framework agreement, such that it would qualify as a category of financial instrument benefiting from the provisions of the financial collateral arrangement regime (which does not completely rule out the risk that a court may recharacterise the derivative as a loan so that the financial collateral arrangement would not benefit from the financial collateral arrangement regime).

Alternatively, French corporate borrowers tend to use English-law documentation and place the shares in the UK for the purpose of ensuring that the security structure under English law can benefit from the financial collateral arrangement regime as implemented in the UK. However, this structure remains largely untested and, in the absence of case law, some commentators have argued that French shares credited to an account in the UK may still be deemed located in

France for the purposes of French insolvency proceedings.

Market structure

What is the structure of the market for listed equity options?

The main market for listed equity options in France is Euronext.Liffe France (the Marché des options négociables de Paris (MONEP) is now integrated in the futures exchange owned by NYSE Euronext). The market undertaking is run by Euronext Paris SA. The Euronext.Liffe France equity option market allows trading of both stock and share index options (such as options on the CAC 40 index, options on European and US indices and on the shares of large companies most active on the Deferred Settlement Service (SRD) system).

Governing rules

Describe the rules governing the trading of listed equity options.

Trading of listed equity options on Euronext.Liffe France is governed by the Euronext Rulebook (the Harmonised Rules in Book I and non-Harmonised Rules for Euronext Paris in Book II). Euronext.Liffe France is organised around a clearinghouse that fixes the required amount of collateral deposit and calculates margin calls (if the position is out-of-the-money) and the relevant settlement price per option. Options expire several times a year. The standard expiry date is the third Friday of the expiry month (calendar month) unless the third Friday is a public holiday and the exchange is closed, in which case it is the third Thursday. For the CAC 40 Index derivatives, Euronext.Liffe France offers weekly futures, mini-index derivatives and total return futures. The participants are clearing members, broker dealers and dealers for own accounts authorised to carry out execution.

TYPES OF TRANSACTION

Clearing transactions

What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

The clearing obligation under Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) requires that all OTC derivative contracts within scope are subject to mandatory clearing and must be cleared with a central counterparty (CCP) that is authorised under EMIR (or that is recognised under EMIR for non-EU CCPs). Currently, EMIR does not mandate for the clearing of equity derivatives. The specific classes of products that are within scope of the mandatory clearing obligation under EMIR are set out in the Annex to the EMIR Delegated Regulation and cover standardised and liquid products (including certain interest rate swaps and credit default swaps). While it is contemplated that equity derivative products will become clearable in the future, the equity derivatives market is already pre-dominantly exchange-based. As a result, equity derivatives that remain traded OTC are generally bespoke products and, therefore, are unlikely to easily meet the standardisation and liquidity requirements for clearable products under EMIR.

Exchange-trading

What categories of equity derivatives must be exchange-traded and what rules govern trading?

There is no legal requirement for any category of equity derivatives to be exchange-traded, even if the types of OTC

derivatives that are exchange-traded are typically equity options and futures. Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments (MiFIR) introduced a mandatory trading obligation for certain types of derivatives (article 28 of MiFIR). It requires financial counterparties (FCs) and non-financial counterparties above the clearing threshold (NFC+) to conclude in-scope derivatives on a trading venue (a regulated market, a multilateral trading facility or an organised trading facility) or an equivalent third country trading venue when they trade with other FCs or NFCs+. This trading obligation applies to any class (or sub-class) of derivatives that has been declared subject to the EMIR clearing obligation, is admitted to trading or traded on at least one trading venue (the venue test), is considered sufficiently liquid to be traded only on venue, taking into account the average frequency of trades, the average size of trades, the number and type of active market participants and the average size of spreads (the liquidity test) and has been declared by ESMA as subject to the trading obligation. However, currently, this trading obligation only applies to certain categories of interest rate swaps and credit default swaps and does not apply to equity derivatives.

Collateral arrangements

Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

For uncleared equity derivatives transactions, counterparties will usually document their collateral arrangements contemplating for the exchange of periodic variation margin as title transfer under an ISDA Collateral Support Annex (under English or French law) to the ISDA Master Agreement or the equivalent local collateral annex under the French Banking Federation (FBF) derivative framework documentation. In that context, Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) imposes risk-reducing and transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (including equity derivatives transactions). In particular, EMIR contemplates risk mitigation techniques for OTC derivatives transactions not cleared by a CCP that include timely exchange of collateral and periodic compression requirements.

For cleared equity derivatives transactions, counterparties will generally document their clearing relationship under a principal-to-principal clearing model with a clearing broker acting as riskless principal (as between the counterparty and the CCP) under an the ISDA/FAO Client Cleared OTC Derivatives Addendum (English law), which works as an addendum to the ISDA Master Agreement (with corresponding French law adjustments for the FBF Master Agreement). In addition, counterparties subject to clearing requirements under EMIR will also have to put in place specific initial margin arrangements to guard against the margin period of risk – that is, the risk that there is not enough posted collateral as variation margin (the requirements for initial margin are currently being phased in depending on the nature of the counterparty).

For listed equity derivatives transactions, the collateralisation requirements will be determined by the relevant clearinghouse.

Exchanging collateral

Must counterparties exchange collateral for some categories of equity derivatives transactions?

The rules for collateralisation of derivatives transactions under EMIR are not specific to equity derivatives transactions. EMIR requires the exchange of variation margin between financial counterparties (credit institutions, insurance undertakings, undertakings for the collective investment in transferable securities, alternative investment fund managers, etc) and between financial counterparties and counterparties that are above the clearing threshold (NFC+), although single stock equity options and index options remain out of scope for a transitional period (while this

transitional period formally ended on 4 January 2020, it was proposed to be extended by one year and, until the extension is formally adopted, the European regulatory authorities have encouraged regulatory forbearance). Currently, equity derivatives transactions are also not subject to clearing.

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

French law applies to counterparties transacting in France, or in respect of French shares or shares listed in France. The scope of directly applicable European legislation is, in general, also limited to the EU and transactions with an EU nexus (although there is a tendency in new proposed regulations to extend beyond EU borders in order to maintain a level playing field between EU and non-EU market participants). Third-country counterparties may be indirectly impacted by French or EU laws in the context of cross-border business. For example, a counterparty located outside of the EU may have to comply with requirements under Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) to allow its French counterparty to comply with its own obligations under EU rules. Notably, EMIR would capture transactions with a 'direct, substantial and foreseeable effect' in the EU or aimed at evading the obligations under EMIR. As a result, to that extent only, some regulations (such as EMIR) may have extra-territorial effect.

Registration and authorisation requirements

What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

At least one of the market participants to an equity derivatives transaction will need to be registered as an eligible institution (a credit institution, an investment services provider, a financing company, etc) for the provisions of the Financial Netting Regime to apply to financial instruments (including equity derivatives transactions) under French law. Importantly, if one of the market participants has to be registered as an eligible institution, it does not need to be registered in France as long as it is a foreign entity with comparable legal status (ie, a licensed foreign institution carrying banking and financial services).

The Financial Netting Regime is the cornerstone of derivatives trading (including equity derivatives) in France as it allows counterparties trading financial instruments to implement the closeout netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings. This is because the provisions of the Financial Netting Regime operate by exception to the general French insolvency regime.

If both counterparties qualify as eligible counterparties for that purpose, the Financial Netting Regime is expanded to apply not only to financial instruments but also to any financial transaction giving right to cash settlement or the delivery of financial instruments.

Reporting requirements

What reporting requirements apply to market participants that deal or invest in equity derivatives?

Refer to 'Reporting obligations' for a description of reporting requirements applicable to market participants that deal or invest in equity derivatives.

Legal issues

What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

No specific legal issue would arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares.

However, where the product is to be listed, Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the Prospectus Regulation) will apply with specific disclosure requirements in relation to the issuer and the underlying (third party's shares, basket or index of shares) as well as the applicable tax regime (as detailed in Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing the Prospectus Regulation).

The following applies:

- where the product is linked to a basket of underlyings, the prospectus must include disclosure of various information in respect of each underlying and its relevant weighting in the basket; and
- where the product is linked to an index, the prospectus must include the name of the index and, where the index is not composed by the issuer, an indication of where information about the index can be obtained and also whether the index constitutes a benchmark under Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) 596/2014 (the Benchmark Regulation). The administrator of an index that qualifies as a benchmark for the purposes of the Benchmark Regulation is required to apply for authorisation and is subject to supervision by the competent authority of the country in which it is located. Also, as the Benchmark Regulation applies to all indices used in the EU regardless of origin, third country administrators located outside the EU are required to seek approval in order to continue to serve their EU customers.

In that context, if the product references an index that constitutes a benchmark provided by external and independent providers, the issuer will be considered a 'user' under the Benchmark Regulation and, as such, the issuer must put in place written plans to designate an alternative if the benchmark used materially changes or ceases to be published (ie, fallbacks) and must ensure the prospectus or investment memorandum includes clear and prominent information stating whether the benchmark is provided by an authorised administrator. Conversely, if the product references a proprietary index that constitutes a benchmark (ie, an index built in-house in order to reduce costs that would otherwise have to be paid to external index providers), the issuer would be considered both a 'user' and an 'administrator' under the Benchmark Regulation (and, therefore, both the requirements for 'user' and the onerous requirements for 'administrator' would apply, in particular in relation to governance arrangements and the management of conflicts of interests).

As far as French tax issues are concerned, structured products might entail, among others, capital gains taxation, loss

of the benefit of favourable tax regime on certain securities income, withholding tax as well as indirect taxation, in particular French transfer taxes or French Financial Transaction Tax (where the shares are French listed shares). The tax analysis will need to be conducted on a case-by-case basis.

Liability regime

Describe the liability regime related to the issuance of structured products.

The liability regime related to the issuance of structured products essentially revolves around various overarching general principles including:

- the sufficiency of the information provided to investors via the disclosure document allowing investors to make an informed investment decision (ie, appropriate content of the prospectus without misstatement or omission);
- the accuracy of the information provided by financial intermediaries to their clients; and
- the suitability of the proposed product to the target market.

Other issues

What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

The offer and sale of a security convertible for shares of the same issuer is generally not subject to the requirements for the drafting, approval and distribution of a prospectus under Regulation (EU) 2017/1129 (the Prospectus Regulation) if the purchasers are qualified investors or the placement is made to fewer than 150 persons per member state of the European Economic Area. Under those circumstances, the convertible instrument would be exempt from registration with the French Financial Markets Authority unless the convertible instrument is admitted to trading on a regulated market – convertible instruments are generally admitted to trading on Euronext Access, an MTF operated by Euronext Paris.

The main legal issues that arise in the offer and sale of a convertible instrument are as follows.

Corporate law

Assuming that the shares underlying the convertible instrument represent a new issuance, shareholders' approval with a two-thirds majority of the shareholders present or represented with a quorum of one quarter of the existing voting rights on first convocation and one fifth of the existing voting rights on second convocation is required. New shares underlying the convertible instrument are generally issued via a capital increase, without the preferential subscription rights that normally apply for existing shareholders. There are two ways to accomplish this:

- the private placement exemption under article L.225-136 of the French Commercial Code, permitting up to 20 per cent of the share capital (or equivalent through exercise of conversion rights) per year to be sold to institutional investors and other related categories; and
- the reserved capital increase under article L.225-138 of the French Commercial Code, permitting the sale of shares to certain designated persons or determined categories of person fixed by the shareholders, with no limit in terms of share capital amount or price (as long as the price or appropriate pricing parameters are approved by the shareholders). Listed issuers often obtain delegations from their shareholders, permitting the board of directors to implement the capital increase that can be sub-delegated to management within proscribed time limits following the shareholders' meeting (26 months for the private placement exemption and 18 months for

the reserved capital increase).

Disclosure

Articles 7 and 17 of Regulation (EU) No. 596/2014 on market abuse regarding the need to provide prompt disclosure of inside information regarding the underlying listed shares (assuming Regulation (EU) No. 596/2014 on market abuse containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation (MAR) applies due to admission to trading on a regulated market or multilateral trading facility in the EEA) would apply if the issuance of convertible instruments is listed on a regulated market. Depending on the circumstances, the issuance of a convertible instrument may be price-sensitive for the listed shares, mandating disclosure of its terms, which, according to recommendations of the Financial Markets Regulator (AMF), should include, among other things, disclosure of the instrument type, nature of the offering or placement, nominal amount, interest rate, maturity, conversion rights, conversion ratio, number of shares that would be issued or granted to satisfy conversion rights, the dilutive effect, issue price, use of proceeds, undertakings assumed by the issuer, share capital of the listed company following the issuance and governance rights of the holders (if any).

Transparency

Article 15.5 of the Prospectus Regulation requires that issuers provide all investors with the same level of information even in offers and sales, which are not subject to the prospectus drafting, approval and distribution requirements of the same. Additionally, the General Regulations of the AMF provide, among other things, the approved and recommended modalities of effective dissemination of regulated information.

Tax

The issuance of convertible securities generally does not trigger any direct or indirect tax issues from a French tax standpoint at the level of the issuer. However, deductibility of interest accrued under such securities may be restricted in the event that the holders are shareholders or related parties to the French issuer. Conversion of convertible securities into equity may entail immediate capital gains taxation at the level of the holders (directly or through withholding taxes mechanism), subject to specific tax rollover regimes that exist under French tax law subject to certain conditions. As far as French indirect taxation is concerned, conversion or transfer of such securities may be subject to French transfer taxes (or to the French financial transaction tax, as the case may be), depending upon the characteristics of the securities and the means pursuant to which the conversion or transfer is realised. A tax analysis generally needs to be conducted on a case-by-case basis.

What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

The offer and sale of a security exchangeable for shares of a third party is generally subject to the same legal issues that are discussed for convertible instruments in 'Other issues', with the exception of the corporate matters as the approval for the issuance of an exchangeable instrument would be subject to local applicable law and the bylaws of the issuer.

Though the MAR generally does not impose a disclosure obligation on a third party issuer with respect to the underlying shares, third-party issuers are still nonetheless subject to article 223-6 of the General Regulations of the

AMF, which imposes an obligation of disclosure on 'any person [preparing] a financial transaction liable to have a significant impact in the market price of a financial instrument, or on the financial position and rights of holders of that financial instrument.' Third-party issuers should take care to comply with the foregoing disclosure obligations, which can be discharged in the manner indicated above. An affiliate issuer may have MAR obligations with respect to the underlying shares if such issuer is an insider with respect to the listed company, and in any case, should likewise comply with article 223-6 of the AMF General Regulations.

UPDATE AND TRENDS

Recent developments

Are there any current developments or emerging trends that should be noted?

In the context of Brexit, French counterparties have recently shown an increasing preference to document their structured equity derivatives transactions under framework documentation (FBF or ISDA) governed by French law (as opposed to English law). This is a concerted effort by French counterparties to hedge the unintended effect of having equity derivatives transactions documented under English law (now a third-party non-EU law) in the absence of a clear roadmap for the withdrawal of the UK from the EU and to address substantive concerns including (but not limited to) the recognition of the choice of law for contractual and non-contractual obligations, the recognition of jurisdiction clauses or the enforcement of foreign judgments. This is in addition to French counterparties now generally requiring that the equity derivatives transactions be booked by the dealer counterparty out of a regulated entity located in the EU (often in France, Germany or Ireland, depending on the dealer counterparty) to alleviate any concern relating to the provision of a regulated MiFID investment service by the dealer counterparty in France out of an entity regulated outside of the EU (especially in the context of future transaction amendments or the occurrence of other lifecycle events). Additionally, France is one of the few EU jurisdictions where corporates routinely use equity derivatives for the repurchase of own shares irrespective of the fact that derivatives do not benefit from the safe harbour provisions of Regulation (EU) No. 596/2014 on market abuse.

LAW STATED DATE

Correct on

Give the date on which the information above is accurate.

April 2020