



PROFESSIONAL OBLIGATIONS OF INVESTMENT SERVICES PROVIDERS TO RETAIL CLIENTS WITH REGARD TO THIRD-PARTY PORTFOLIO MANAGEMENT

Reference documents: Article L. 533-12 of the Monetary and Financial Code and Articles 314-3, 314-11 and 314-12 of the AMF General Regulation

The service of third-party portfolio management is an investment service defined in Article D. 321-1 of the Monetary and Financial Code as "the act of managing, in a discretionary and personalised manner, portfolios including one or more financial instruments or one or more units mentioned in Article L. 229-7 of the Environment Code under a mandate given by a third party".¹ The provision of this investment service as a regular business requires authorisation as an investment services provider.²

The provision of third-party portfolio management is governed notably by the provisions drawn from Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014, referred to as "*MiFID II*", transposed into the Monetary and Financial Code, and from its delegated implementing acts, notably Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, and by certain provisions of the AMF General Regulation. MiFID II reinforces the existing obligations and introduces new ones: disclosure of costs and charges, product governance, ban on retaining any payments or inducements paid or provided by third parties, and alerting the client if the portfolio should drop by more than 10% and for each multiple of 10%.

This document concerns only the provision to retail clients of the third-party portfolio management service mentioned in 4 of Article L. 321-1 of the Monetary and Financial Code. It does not aim to list all the rules applicable to the provision of this investment service to retail clients such as, for example, the rules applicable to payments and inducements received within the framework of discretionary management, or again the applicable rules regarding anti-money laundering and combating the financing of terrorism³.

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

¹ Methodically, in this document the expression "financial instrument" refers to financial instruments within the meaning of Article L. 211-1 of the Monetary and Financial Code and the units mentioned in Article L. 229-7 of the Environment Code.

² Subject to the provisions of Article L. 531-2 of the Monetary and Financial Code.

³ As regards the rules applicable to anti-money laundering and combating the financing of terrorism, investment services providers may usefully refer to the Guidelines published by the AMF for asset management companies (AMCs), and by the Autorité de Contrôle Prudentiel et de Résolution for investment services providers excluding AMCs.

I - AGREEMENTS SIGNED WITH RETAIL CLIENTS

Reminder of the applicable provisions

Article 58 of the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 (hereinafter the "Delegated Regulation") provides that "*Investment firms providing any investment service or the ancillary service referred to in Section B(1) of Annex I to Directive 2014/65/EU to a client after the date of application of this Regulation shall enter into a written basic agreement with the client, in paper or another durable medium, with the client setting out the essential rights and obligations of the firm and the client. Investment firms providing investment advice shall comply with this obligation only where a periodic assessment of the suitability of the financial instruments or services recommended is performed.*

The written agreement shall set out the essential rights and obligations of the parties, and shall include the following:

- a) a description of the services, and where relevant the nature and extent of the investment advice, to be provided;*
- b) in case of portfolio management services, the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken on behalf of the client, as well as any instruments or transactions prohibited; and*
- c) a description of the main features of any services referred to in Section B(1) of Annex I to Directive 2014/65/EU to be provided, including where applicable the role of the firm with respect to corporate actions relating to client instruments and the terms on which securities financing transactions involving client securities will generate a return for the client".*

In accordance with the second paragraph of Article 1 of the Delegated Regulation, "*References to investment firms shall encompass credit institutions [...]*".

The aforementioned Article 58 also applies to asset management companies authorised to provide one or more investment services in accordance with VII of Article L. 532-9 of the Monetary and Financial Code.

Article 314-11 of the AMF General Regulation provides that, "*Without prejudice to the provisions of Article 58 of the Commission Delegated Regulation 2017/565 of 25 April 2016, agreements concluded between the investment services provider and non-professional clients shall contain specific stipulations concerning the detailed information to these clients about the characteristics and modalities of the investment service provided and on the rights and obligations of the parties.*"

The aim of the following discussion is to clarify the specific stipulations of the agreements for provision of the third-party portfolio management service concerning information to be provided to retail clients by the service providers in question regarding the characteristics and modalities of the investment service provided and the rights and obligations of the parties, in accordance with Article 314-11 of the AMF General Regulation.

1. MINIMUM CONTENT OF MANAGEMENT MANDATES SIGNED WITH RETAIL CLIENTS

The management mandate shall contain at least the following information:

1. The identity of the person(s) with whom the agreement is established:
 - a) Where this involves a legal entity, the procedures for informing the service provider of the name of the persons authorised to act in the name of said legal entity;
 - b) Where this involves a natural person, his/her capacity, as a French resident, a resident of a State which is a party to the European Economic Area agreement or a resident of a third country, plus, where applicable, the identity of the persons authorised to act in the name of said natural person;

2. The investment management objectives.

Position

The investment management objectives shall be clear and defined according to the client's investment objectives, including his (her) risk tolerance, knowledge, experience and financial position, including his (her) ability to bear losses.

For this purpose, the management mandate shall specify these investment management objectives:

- the risk level;
- the investment horizon; and
- the main characteristics of the investment policy to be implemented by the discretionary manager, i.e. the asset allocation strategy, target breakdown of this allocation by asset class and the existence of a floor and/or ceiling for certain types of financial instruments or a reference to a certain investment management strategy.

The implementation of "discretionary" management under a mandate, i.e. investment management providing that the composition of the managed portfolio may vary depending on the investment policy judged appropriate by the investment services provider, shall be a possibility available to the latter provided that the mandate indicates explicitly and clearly the special features, benefits and drawbacks entailed in this type of investment management, the investment management objective, degree of risk and any particular constraints where applicable, and delimits the leeway left to the investment services provider.

Recommendation

The AMF recommends that, before signing the mandate, the risk/return profile be presented according to the target allocation in the form of a synthetic indicator as follows:

- The synthetic indicator ranks the management mandate on a scale ranging from 1 to 7, based on its past results with regard to volatility;
- This scale appears as a series of categories identified by integers ranging from 1 to 7, ranked in ascending order from left to right and representing the risk and return levels, from the lowest to the highest;
- The scale indicates clearly that a lower risk corresponds to a potentially lower return and, conversely, that a higher risk corresponds to a potentially higher return;
- No colour is used to distinguish the items placed on the scale from one another;
- The figure selected, ranging from 1 to 7, must be clearly identifiable.

The SRRI is determined, before signing the mandate, according to the market conditions at that time. It may evolve depending on market conditions, even when there is no movement on the portfolio.

The AMF recommends that this information be available subsequently at least in the periodic report on investment management activities.

Recommendation

The AMF recommends not using the designation "cautious profile" for a portfolio having more than 30% net asset exposure to risky assets such as equities, speculative (high-yield) bonds or all types of assets which might represent a source of high potential risk for the client. If the "cautious profile" designation is used, the remaining pocket of at least 70% is then invested in securities having a lower risk than the aforementioned risky assets.

Recommendation

When the investment management objective indicates a benchmark indicator for the purpose of comparing performance, the AMF recommends that this benchmark be clearly identified and defined precisely. A reference is not sufficient. If an indicator is available in a version that takes into account reinvested dividends, the AMF recommends that the portfolio's performance be systematically compared to that of said indicator in order to avoid providing investors with potentially misleading information. Should the indicator only be available in a version that does not take into account dividends, the AMF recommends that the information provided be as clear as possible regarding the bias affecting the comparison between the performances of the indicator and the portfolio.

3. Types of financial instrument that can be included in the portfolio.
The instruments authorised without receiving a special explicit agreement as mentioned in 6 hereafter are as follows:
- a) Financial instruments traded on a regulated market referred to in Articles L. 421-1 and L. 422-1 of the Monetary and Financial Code, or on an equivalent third-country market⁴ or on a recognised foreign market for financial securities, referred to in Article L. 423-1 of said code.
 - b) French and foreign UCITS authorised in accordance with the 2009/65/EC Directive of the European Parliament and of the Council of 13 July 2009 and French AIFs open to retail investors;
 - c) Financial contracts traded on a market appearing on the list determined by an official ministerial decision.

Position:

The characteristics of the financial instruments used should be described in the management mandate.

Investment in collective investment products

Without prejudice to the obtainment, where applicable, of the agreement mentioned in point 6 below, when the financial instruments used in the management mandate are collective investment products, the management mandate shall specify their type (UCITS, retail investment fund ('FIVG'), private equity fund, OPCV, SCPI, SEF, GFI, SICAF, fund of alternative funds, professional general investment fund, professional organisation for collective real estate investment, specialised professional funds, including Sociétés de Libre Partenariat (Limited Partnerships), professional private equity investment funds, employee savings scheme funds, securitisation organisations, specialised financial institutions, other AIFs, and other collective investments).

Where applicable, it shall be explicitly provided that the discretionary manager may subscribe to or invest in collective investment products managed, even by delegation, by itself or by an affiliated company, or in financial securities issued by a company in the group.

Unless otherwise agreed, deferred settlement transactions shall be unwound at the date of expiry with no possibility of carry-over.

4. Procedures for informing the client regarding the management of his (her) portfolio;
5. Duration, conditions of extension and termination of the mandate. This contract may be terminated at any time by the client or the discretionary manager and contains the conditions of its termination.

⁴ A third-country market is here considered as equivalent to a regulated market provided that the European Commission has passed an equivalence decision relating to the market of the third country in question in accordance with paragraph 4 of Article 25 of the 2014/65/EU Directive of the European Parliament and of the Council as amended by the 2016/1034/EU Directive.

No later than the effective date of termination, the discretionary manager shall draw up a portfolio statement and finalise a management report showing the investment management results since the last portfolio statement; it shall give all useful clarifications to the client regarding the nature of open interest positions.

Recommendation

The AMF recommends inserting in the management mandate an indication that the client will manage his/her own portfolio on the effective date of termination of the mandate, unless he/she appoints another discretionary manager.

6. When the mandate authorises transactions on financial instruments other than those mentioned in 3° or with a leverage effect, in particular transactions executed on financial contracts, the special and explicit agreement of the client must be given, clearly indicating the instruments authorised, and the conditions of these transactions and the client's information.

Position

The agreement shall define explicitly and exhaustively the transactions authorised, in terms of the markets or instruments concerned, the nature of the transactions and the incurred risk limits. It shall cover in particular the hedging and/or speculative transactions authorised by the mandate, the maximum losses authorised, or again the maximum fraction of the portfolio exposed to these markets and/or these products.

Recommendation

If the mandate provides for the possibility of investing in collective investment products open to professional investors and/or in foreign funds not authorised for marketing in France and/or in complex financial instruments in the sense that they do not comply with the conditions of Article D. 533-15-1 of the Monetary and Financial Code, the AMF recommends that the mandate should specify the maximum fraction of the client's portfolio that can be invested in said investment products, funds or financial instruments.

7. Where applicable, an indication of the conditions of collection of performance fees when the management fees include a variable share depending on the managed portfolio's outperformance relative to the investment management objective.

Recommendation:

When the management fees include a variable fraction, the AMF recommends that:

1. it should not incite the discretionary manager to take excessive risks in the hope of increasing the discretionary management performance. The share in the portfolio's outperformance awarded to the discretionary manager is likely to lead said manager to take excessive risks whenever it exceeds the 30% threshold;
2. it should be compatible with the investment management objective and the risk profile of the management mandate which was presented to the client;
3. the calculation of performance can be verified, to prevent any possible manipulation. In this context, the frequency with which the discretionary manager debits fees should be reasonable. Note that a period of one year is considered reasonable. Accordingly, a debiting period of less than one year could not be considered appropriate;
4. the client should be informed of the existence of performance fees and of their potential impact on the return on investment under the management mandate.

8. The obligations of confidentiality incumbent on the investment services provider in accordance with the laws and regulations in force concerning professional secrecy;

9. The price scale for the service provided by the investment services provider, including, where applicable, the charges referred to in Article 314-26 of the AMF General Regulation, and the conditions of remuneration of the investment services provider.

Position:

This price scale shall include all costs and charges incurred by the client for the investment management service (management fees, intermediation costs, turnover commission, etc.), provided that sufficient information be disclosed to the client on how this presentation fits in with that required under Article 50 of the Delegated Regulation.

The management mandate shall specify the basis of and procedures for calculating charges.

2. OTHER INFORMATION APPEARING IN THE MANDATE SIGNED WITH A RETAIL CLIENT

Position

Direct marketing of banking or financial products

When the client has been solicited in the conditions provided for in Articles L. 341-1 et seq. of the Monetary and Financial Code, they shall have a right of withdrawal for 14 full calendar days. The mandate must therefore provide for a withdrawal form.

Complaints and Mediation

The mandate shall provide contact details of the competent mediator(s), and in particular the AMF Ombudsman.

Conflicts of interest

The mandate shall indicate on which medium the discretionary manager provides the client with a general description of the policy followed with regard to conflicts of interest.

Withdrawals

The mandate shall indicate the consequences that may arise from withdrawals of cash or financial instruments. This concerns, in particular, tax consequences and difficulties that the discretionary manager might face to achieve the investment management objective defined in the mandate. The discretionary manager shall draw the client's attention to the possibly illiquid nature of the financial instruments of which the portfolio may be formed.

II. OTHER OBLIGATIONS OF INVESTMENT SERVICES PROVIDERS WITH REGARD TO RETAIL CLIENTS

1. INVESTMENT SERVICES PROVIDER IN CHARGE OF PORTFOLIO MANAGEMENT AND CUSTODY ACCOUNT-KEEPER

Recommendation

The AMF recommends, especially when the service provider delegates to the custody account-keeper the sending of certain documents such as the periodic statement, that it first systematically compare the positions that it records for its clients with those booked by the custody account-keeper.

Moreover, insofar as there exists a direct legal link, in which the investment services provider is not involved, between the discretionary management client and his (her) custody account-keeper, the AMF reiterates that the investment services provider may not, without the explicit agreement of their joint client, decide to transfer his (her) assets from one custody account-keeper to another.

This has important implications for clients because it concerns the protection of their assets (the obligation of restitution by the custody account-keeper of the securities that are entrusted to it by its clients is laid down in 5° of Article 322-7 of the AMF General Regulation).

Position

As it is often in the interest of the investment services provider to encourage its clients to open their securities account with a designated custody account-keeper with which it has defined operating processes, it must endeavour to ensure that the relationship between its clients and said institution is established in accordance with the interests of the client.

2. PROSPECTIVE ALLOCATION OF ORDERS

Position

To provide sufficient guarantees regarding the pre-allocation of orders, an allocation software must include an unmodifiable and tamper-proof time-and-date stamping procedure and must not contain any non-traceable reallocation mechanism.

3. DISCRETIONARY PORTFOLIOS INVESTED IN UNLISTED SECURITIES

Investment services providers performing third-party management of portfolios consisting of non-voting shares or equity securities of companies, or securities giving access to the capital of companies, not admitted to trading on a regulated market ("unlisted securities"), are also subject to the following positions and recommendations.

The AMF gives a reminder that investment services providers can perform third-party investment in unlisted securities only if their programme of activity provides for this and if a conflicts of interest management policy has been established.

3.1. Marketing

Position

Marketing materials relating to an offer for a discretionary portfolio invested in securities not listed on a regulated market shall be submitted to the AMF prior to their dissemination.

The target companies in which the discretionary manager might intend to perform third-party investment may not be offered to the client. Only a presentation of the sector of activity or a presentation of anonymised companies shall be tolerated.

3.2. Conflicts of interest

Recommendations

Given the possible difficulty for the discretionary manager of taking sufficient measures to ensure that the risk of harming clients' interests will be averted, the AMF recommends, for example, and without this list being exhaustive, that the following situations be brought to clients' notice:

- Situations of conflicts of interest due to co-investment with other funds or portfolios managed by the discretionary manager;
- Situations of conflicts of interest due to the conditions of remuneration of the discretionary manager;
- Situations of conflicts of interest due to relations⁵ between the discretionary manager or an affiliated company and the target.

3.3. Investment in preference shares

Position

When marketing material is presented to the client, the discretionary manager intending to perform third-party investment in preference shares shall include in said presentation the impact of that investment.

The risk/return profile of the preference shares over the recommended investment horizon of the mandate must be illustrated in the marketing material by means of one or more scenarios.

These scenarios are intended to show:

- The cap on performance;
- The risk of loss of capital.

When the discretionary manager intends to invest in redeemable preference shares on the initiative of the target company's incumbent shareholders, this mechanism may not be presented as a liquidity mechanism.

3.4. Valuation

Position

The investment services provider shall inform clients of the methods of valuation of the unlisted securities and shall specify that this valuation is performed at fair value.

The portfolio's performance reported in the periodic report on investment management activities or in marketing material shall not include tax benefits.

⁵ This may be business relationships, capitalistic relations or any other sort of link existing between the investment services provider or an affiliated company and the target company.