AUTORITÉ DES MARCHÉS FINANCIERS
AMF

AMF RECOMMENDATION

DOC-2024-04

IMPLEMENTING A DIFFERENTIATED PORTFOLIO TRANSPARENCY REGIME FOR ACTIVELY MANAGED ETFS

Reference texts: Articles D. 214-22-1 and D. 214-32-31 of the Monetary and Financial Code, and Articles 411-134 and 421-27-2 of the AMF General Regulation

1. SUBJECT OF THE RECOMMENDATION

This recommendation applies to asset management companies authorised in France and to asset management companies authorised in another European Union Member State or in a state party to the European Economic Area (hereinafter referred to as “asset management companies”) which manage Exchange Traded Funds (“ETFs”) domiciled in France, and which have an “active” investment strategy[1] (hereinafter referred to as “active ETFs”).

The aim of this recommendation is to specify the conditions under which differentiated access to the exact composition of active ETF portfolios may be set up, depending on the nature of the market participants, and more specifically depending on whether these are authorised participants and market makers on the one hand or any other market participants on the other hand.

Implementing a differentiated portfolio transparency policy must not have the effect of enabling players who benefit from increased transparency to employ the practices (market timing and late trading) described in AMF Position DOC-2004-07.

2. IMPLEMENTING A DIFFERENTIATED PORTFOLIO TRANSPARENCY POLICY

2.1. Background information

An ETF is a collective investment undertaking that has at least one category of units or shares that can be traded continuously on a regulated market. The secondary market is animated by at least one market maker who commits toward the market operator to display quotations[2] continuously[3] for minimum buy and sell order sizes within a maximum bid-ask spread.

An ETF’s admission to trading on a regulated market is conditional on the guarantee that at least one market maker will animate the secondary market. For this reason, an asset management company that issues an ETF enters into a contract with at least one market maker under which the latter commits to the market operator to animate the

[1] i.e. ETFs whose investment strategy is neither index-based (“index-based ETF”) nor algorithm-based (“algorithm-based ETF”). More generally, the manager has discretionary power over the composition of the portfolio, usually with the aim of outperforming a benchmark index.
[2] Simultaneous buy and sell orders.
[3] The platform requires a minimum daily presence, generally close to 100%.

secondary market[4]. Under this contract, it may be stipulated that the market maker will offer a higher quality of liquidity provision than that required by the market operator (e.g. tighter spreads, larger order sizes or a presence in the orderbook almost 100% of the time).

In order for the market maker to be in a position to display competitive quotations in all circumstances, it must be able to (i) value the ETF and (ii) hedge its risks. To achieve this, the market maker needs to know the composition of the ETF's basket of assets as precisely as possible. Generally, the asset management company of an ETF makes this information available to market makers and authorised participants on a daily basis, prior to the opening of the European markets, in the form of a PCF (Portfolio Composition File), which is published simultaneously or one day later on its website.

The manager of an active ETF implements an investment strategy that includes an element of judgement based on research (fundamental, quantitative or other), which constitutes an added value compared to a passively managed ETF, which investment strategy is by nature more systematic[5]. However, the immediate, daily and total disclosure of the portfolio of an active ETF would potentially allow other players to replicate the strategy, or even '*reverse engineer*' it.

2.2. Principles governing a differentiated disclosure policy for active-ETF portfolios

When dealing with market makers and authorised participants[6], the AMF recommends that investment management companies that issue an active-ETF comply with the following principles:

1. **By nature, an asset management company has free rein over its PCF and can choose the authorised participants and market makers with which it wishes to work.** For example, an asset management company may not wish to enter into a contract with certain entities whose business model consists essentially, from its point of view, of carrying out high-frequency arbitrage operations without really seeking to have its quotations passively traded under normal market conditions. These arbitrage operations are generally carried out under stressed market conditions, which could discourage market makers from offering quality liquidity to end investors in all circumstances.
2. **The asset management company's should encourage competition between market makers** in order to improve the liquidity of its products and, thus, assure investors that the prices displayed in the order book properly reflect the *market value* of the ETF. The asset management company may, for example, provide certain objective criteria or preconditions to which market makers must comply in order to enter into a contract with it. For example, the market maker:
   - has a market maker status for the active ETF in question on at least one regulated market in a State party to the European Economic Area[7];
   - has signed a confidentiality agreement with the asset management company, under which it undertakes to only disclose the composition of the active ETF portfolio to those persons who need this information as part of their function;
   - undertakes to animate the secondary market for the active ETF by complying with certain requirements which may, where applicable, be more stringent than those imposed by the trading venue on which it has the status of liquidity provider.
3. **The asset management company makes the PCF of the active ETF available outside European markets' opening hours to all the market makers with which it has contracted, simultaneously and via the same**

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[4] For a fee, where applicable.
[5] The sole management objective of index- and algorithm-based ETFs is to replicate the performance of their benchmark as closely as possible without seeking to outperform it.
[6] While the same entity can be both the market maker and authorised participant for an ETF, both functions are not the same: the market maker animates the secondary market and the authorised participant animates the primary market by acting as an intermediary between the AMC and the market participants (including market makers) wishing to carry out unit creation/cancellation operations, subject to a minimum block size. Therefore, an authorised participant's role is essentially one of execution, without taking risk on own account, and implies that it must know the exact composition of the ETF's portfolio in order to carry out these operations (unless the AMC has put in place a protocol that distinguishes between different authorised participants, e.g. "primary" and "secondary" authorised participants).
[7] Multilateral trading facilities are not mentioned because an ETF can be listed on an MTF without the prior agreement of the AMC.

distribution channel. Therefore, market makers only know the precise impact of the transactions carried out on the portfolio of an active ETF when the new PCF is communicated.

4. **When the asset management company plans to carry out transactions on behalf of an active ETF, including during the trading day, it may communicate its intention in advance to all the market makers with which it has a contract, simultaneously and using the same distribution channel, providing sufficiently general information about the planned transactions to prevent the market maker from identifying the specific securities that will be bought and sold.** The aim here is to eliminate any risk of front-running by market makers. This information provided to market makers may enable them to assess whether or not they need to widen their quotation spreads to take into account the uncertainty created by the changes made to the composition of the portfolio[8].
5. **The conditions governing operations to create/cancel active-ETF units or shares on the primary market are negotiated freely between the asset management company and the authorised participants[9], as is already the case for index- or algorithm-based ETFs.** These conditions are designed, for example, to ensure that operations to create/cancel units or shares on the primary market are executed at a price that reflects the value of the ETF's assets, adjusted for the liquidity cost of the assets bought or sold by the ETF.
6. **The asset management company publishes the exact composition of its active-ETF portfolios at least once a month, with a delay not exceeding one month.** This gives end investors access to the composition of active-ETF portfolios under conditions similar to those for traditional (non-ETF) active funds. A minimum publication frequency (monthly) and a maximum delay (one month) reflect the fact that ETFs are designed to be more transparent than non-ETF funds.

[8] Illustrative (and therefore non-exhaustive) examples of the kind of information that AMCs may disclose to market makers include: (i) the proportion, in the form of a range, of the portfolio that will be affected by the operations, (ii) the correlation between the securities that will enter the portfolio and the ETF's current basket, (iii) and the currency and venue/country of listing of the securities that will enter (and not of those of that will exit) the portfolio.
[9] In Europe, APs are usually MMs.