

DISTRIBUTION OF ACTIVELY MANAGED CERTIFICATES (AMC)

Reference texts: Articles L. 533-11, L. 533-13, L. 541-8-1 and D. 533-15-1 of the Monetary and Financial Code, Articles 44 and 50 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, and Articles 313-11, 313-18, 325-12, 325-14 and 325-31 of the AMF General Regulation

The distribution of actively managed certificates (AMCs) to retail clients has increased in recent years. In this context, a growing number of financial market participants (notably private banks, portfolio management companies and financial investment advisors) have informed the AMF of their wish to develop this activity.

In response the AMF conducted a study between July 2023 and March 2024 of a certain number of professionals involved with these financial instruments (final distributors, intermediary distributors and issuers). This study brought to light deficiencies on the part of the professionals interviewed in implementing the applicable regulatory requirements and a lack of knowledge of the information contained in the AMF doctrine, even though these are highly complex financial instruments. It was noted, in particular, that:

- The regulatory documentation provides for a very broad investment universe for the index or basket, without correlation with the actual investment universe;
- The target markets defined are very broad and do not take into account the specific characteristics of these financial instruments (with regard to rebalancing and, in certain situations, the leverage associated with the financial instrument) nor, where applicable, the complexity of the underlying that may make up the investment universe;
- The investor is only very rarely informed of the composition of the underlying at the point when they invest in the AMC and updates to the composition of this underlying are never communicated to them;
- The information communicated about costs and charges rarely includes rebalancing costs, which are far from negligible, especially when the AMC is frequently rebalanced;
- Before providing the service, the distributor never ensures that the investor understands the atypical operation of these AMCs;
- The financial market participants are misunderstanding AMF Position DOC-2010-05.

The aim of this document is twofold:

- to draw professionals' attention to certain regulatory requirements applicable in the context of the distribution of AMCs (while this document mentions certain applicable obligations arising from MiFID II and its implementing texts, it does not provide an exhaustive list of all the obligations applicable to the situations described (the obligations relating to the Prospectus Regulation are, for example, not covered)); and
- to make recommendations for better investor protection.

The recommendations made are presented in boxes.

1. SCOPE OF APPLICATION

1.1. Financial instruments concerned

The actively managed certificates (AMCs) referred to in this document are:

- (i) structured debt securities; and
- (ii) equivalent financial securities issued on the basis of foreign rights

whose performance depends on an underlying (basket or index) the composition of which can be modified¹ ('rebalanced') in a discretionary manner during the life of the financial instrument, without it being necessary to obtain the agreement of the end investors.

1.2. Situations concerned

This document concerns the distribution of AMCs in France to retail clients², in the context of the provision of a service of:

- investment advice, as defined in Article D. 321-1 (5) of the Monetary and Financial Code;
- portfolio management on behalf of third parties, as defined in Article D. 321-1 (4) of the Monetary and Financial Code; and/or
- execution (reception and transmission of orders on behalf of third parties, and execution of orders on behalf of third parties, as defined in Article D. 321-1 (1) and (2) of the Monetary and Financial Code);

whether this distribution takes place at the initiative of the professional or at the client's own initiative³.

The term 'client' used in this document refers solely to 'retail' clients. This document does not cover the distribution of AMCs to professional clients and eligible counterparties.

1.3. Financial market participants concerned

This document is intended for:

- investment services providers (including portfolio management companies) providing or wishing to provide one or more of the investment services referred to in section 1.2 (if they have the necessary authorisations) on the financial instruments referred to in section 1.1., including their tied agents; and
- financial investment advisors (FIAs) providing or wishing to provide the service of investment advice⁴ for the financial instruments referred to in section 1.1.

In this document, these financial market participants are collectively referred to as 'professionals'.

2. REGULATORY REQUIREMENTS

2.1. Product governance

In accordance with Articles 313-11 and 313-18 of the AMF General Regulation⁵, a professional is required to identify the target market for each financial instrument for which it is the 'manufacturer' and/or 'distributor'. It

¹ For example, by adding or removing an underlying reference asset or by changing the weightings of the different reference assets.

² Retail clients are those clients referred to (a) in Article D. 533-4 I (2) of the Monetary and Financial Code excluding those clients covered by Article D. 533-12 (2) of the Monetary and Financial and (b) in Article D. 533-11-1 of the Monetary and Financial Code.

³ Throughout this Recommendation, the term 'client' refers to both clients and prospects alike.

⁴ FIAs are not authorised to provide the service of receiving and transmitting orders on behalf of third parties, except when the underlying is a collective investment undertaking (CIU), which is not the case here.

⁵ Article 313-18 of the AMF GR is applicable to FIAs in their capacity as distributors.

must therefore identify the type(s) of client(s) who have needs, characteristics and objectives, including, where appropriate, sustainability related objectives, that are compatible with this financial instrument.

ESMA has published Guidelines⁶ providing, in particular, details on how these target markets must be identified. The AMF has stated its application of these Guidelines through AMF Position DOC-2018-04⁷.

In the context of the distribution of AMCs, the AMF reminds professionals that they are required, in particular, to:

- have detailed target markets taking into account the complexity of these financial instruments (§24, 25 and 50 of the Guidelines);
- carry out a very detailed assessment of the target market (§26 and 50 of the Guidelines);
- have a distribution strategy that is consistent with the target market identified (§32, 33, 37 and 60 of the Guidelines);
- for distributors, define their own target market (§46 of the Guidelines)

Recommendation

With regard to the ‘knowledge and experience’ criterion of the target market (§19.b) and 42 of the Guidelines) and given the complexity of AMCs, in order to ensure that the clients who will hold them in their portfolio are able to understand how they work and the associated risks, the AMF recommends restricting the ‘positive’ target market for these financial instruments to only those clients with the highest level of knowledge and experience, and placing clients with a low level of knowledge and experience in the ‘negative’ target market.

For AMCs that do not have the specified characteristics mentioned in example 2c⁸ of AMF Position DOC-2010-05, the professional may carry out an analysis to identify whether clients with a lower level of knowledge and experience could also be included in the positive target market, and whether a negative target market should be identified.

2.2. Provision of information to clients

The AMF recalls that in accordance with Article 44 of Delegated Regulation (EU) 2017/565⁹ &¹⁰, professionals are required to communicate fair, clear and not misleading information to all of their clients. In particular, the AMF draws professionals’ attention to the fact that this information must not disguise or diminish items, statements or warnings: this implies that the client has information about the specific characteristics of the AMCs distributed (including the discretionary nature of the underlyings) and on the consequences in terms of risks.

2.2.1. Information to be communicated *ex-ante*

The AMF points out that this obligation to communicate fair, clear and not misleading information also implies that the information communicated to clients is up-to-date. This requires, in particular, that the client (or the person acting on their behalf) possesses information, before investing, on the actual composition of the underlying (index or basket) of the AMC on that date.

⁶Guidelines on MiFID II product governance requirements (ESMA35-43-3448 – Guidelines).

⁷Extension of the application of these Guidelines to FIAs through AMF Position DOC-2006-23.

⁸Rebalancing of the assets underlying the financial instrument more than once a year, combined with at least one element of complexity.

⁹Delegated Regulation (EU) 2017/565 of the Commission of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MiFID II DR).

¹⁰Article 325-12 of the AMF GR for FIAs.

Furthermore, under Article 50.2 of the MiFID II DR¹¹, professionals are required to communicate to clients, prior to the provision of the service, an estimate of “*all costs and associated charges associated with the manufacturing and managing of the financial instruments*”¹².

In addition, the costs communicated *ex-ante* to clients upstream of the provision of an investment service linked to an AMC must, in particular, contain an estimate of the rebalancing costs (the latter being linked to the management of AMCs). In the case of portfolio management on behalf of third parties, these costs are included in the overall costs communicated by the professional as part of the provision of this service.

Recommendation

The AMF recommends that professionals estimate rebalancing costs in a manner similar to the methodology put forward by ESMA for estimating the costs associated with managing an individual portfolio prior to the provision of the portfolio management service on behalf of third parties¹³.

The AMF therefore recommends that professionals estimate the rebalancing costs of a given AMC based on (i) the underlying assets, (ii) the number or volume of anticipated annual rebalancing operations (by using historical data from a comparable AMC, for example) and (iii) the rebalancing costs linked to each underlying asset of the portfolio. It also invites them to provide the client with more precise information on how the costs have been estimated.

2.2.2. Regular provision of information to clients

Recommendation

The AMF invites professionals to provide¹⁴ to clients holding an AMC in their portfolio, on at least a quarterly basis, information about the costs related to holding this AMC incurred during this reference period and:

- a statement detailing the composition of the AMC at the end of the reference period; or
- a report on the management carried out during the reference period.

In either of these situations, the AMF recommends that the document communicated contains, as a minimum, information on: eligible assets, the components of the AMC on the date of the statement or report (asset class, theme, risk level), the net value of each unit, the terms and conditions of early exit, and the movements that took place during the reference period.

2.3. Assessment of suitability and/or appropriateness

2.3.1. Knowledge and experience

In accordance with Article L. 533-13, I and II of the Monetary and Financial Code, regardless of the investment service linked to the distribution of the AMC (investment advice, portfolio management on behalf of third parties, execution of orders on behalf of third parties and/or reception and transmission of orders on behalf of third parties), the professional is required to verify the retail client’s level of knowledge and experience in relation to the specific type of financial instruments distributed.

¹¹ Article 325-14, II of the AMF GR for FIAs.

¹² It is recalled that these costs must also be included in the KID PRIIPs communicated to clients in accordance with paragraph 33.b) of Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.

¹³ See ESMA_QA_1836.

¹⁴ This information may be provided in a manner similar to that relating to other financial instruments in the portfolio in the event of the provision of a portfolio management service on behalf of third parties.

With regard to AMCs, the AMF recalls that professionals are therefore required to assess the client's level of knowledge and experience with regard to the specific characteristics of these financial instruments, as well as with regard to all the financial instruments that may comprise or be included in the underlying asset (whether this is structured in the form of a basket or is an index). The AMF also points out that this assessment should not be performed by means of a self-assessment carried out by the client themselves in order to ensure that the client truly understands how the AMC works, as well all the financial instruments that may form part of the underlying.

2.3.2. Execution only

The AMF recalls that AMCs cannot be considered to be 'non complex' financial instruments – they do not fall under Article D. 533-15-1 of the Monetary and Financial Code. Consequently, they do not meet condition 1° of Article L. 533-13, III of the Monetary and Financial Code and are therefore not eligible for the 'execution only exemption, which allows, among other conditions, an investment services provider to provide a service of reception and transmission of orders, or execution of orders on behalf of third parties without ensuring the appropriateness of the service or financial instrument.

3. APPLICABILITY OF AMF POSITION DOC-2010-05¹⁵

The AMF recalls that AMCs, since they can be 'rebalanced' more than once a year and have an additional element of complexity¹⁶ fall within the scope of application of criterion 2 of AMF Position DOC-2010-05: "*Unusual nature for the retail client of the financial instrument due to the underlying(s) used*". In this situation, inclusion under criterion 2 does not in any way depend on the financial instruments making up the basket or included in the index underlying the AMC. Further, an AMC that only replicates the performance of shares could also fall within the scope of this criterion 2, even though the financial instruments included in or making up the underlying are not complex.

Also, if their distribution to retail clients takes place within the framework set by AMF Position DOC-2010-05, the statement that "*it will be particularly difficult for them to comply with applicable legislative and regulatory requirements relating to marketing*" applies.

4. OTHER AREAS FOR ATTENTION

4.1. Capacity of the persons determining the composition of the underlying

Recommendation

To fulfil their obligation to act in the best interests of the client¹⁷, the AMF invites professionals who would like to distribute AMCs to retail clients despite the risks in terms of non-compliance with legislative and regulatory requirements that this entails to include in their offer aimed at these clients only those AMCs for which the person(s) determining the composition of the underlying (index or basket) has/have the necessary authorisations to provide collective investment management and/or portfolio management activities on behalf of third parties (or has/have an equivalent authorisation granted in a foreign country).

¹⁵ Marketing of complex financial instruments (AMF Position DOC-2010-05).

¹⁶ This is the case, for example, when 'rebalancing/reallocation charges' (or equivalent charges) are deducted from the value of the AMC at the time of rebalancing.

¹⁷ Articles L. 533-11 and L. 541-8-1 1° of the Monetary and Financial.

4.2. Direct marketing

The AMF reminds professionals that in accordance with Article L. 341-10 (4) of the Monetary and Financial Code, AMCs cannot be the subject of financial direct marketing (as defined in Article L. 341-1 of the Monetary and Financial Code) if they have not been admitted to trading on a regulated market and are not the subject of a public offer requiring the preparation of a Prospectus¹⁸.

4.3. Public offer

The AMF reminds professionals that AMCs issued in the form of debt securities are financial securities subject to the obligations relating to public offers laid down in Articles L. 411-1 *et seq.* of the Monetary and Financial Code.

¹⁸ In accordance with Regulation (EU) No 2017/1129 of 14 June 2017.