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WHITE PAPER
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A Primer on Actively Managed Certificates

Foreword

Dear Readers,

Innovation offers companies an opportunity to thrive. With the rise of a new era of technology and digital transformation, asset managers, investors, and service providers like management companies and administrators must adapt to the evolving landscape.

The demand for specialized and tailored strategies is growing. Integrating digitalization solutions allows for such investments without the historically associated high costs. At the same time, digitizing such processes also reduces the likelihood of errors. Regulators expect more transparency and disclosure of active portfolio management strategies, making data quality crucial.

The adaption of technology presents clear opportunities for active investment management to provide scalable and customized products while simultaneously being transparent and price competitively.

The Actively Managed Certificate (AMC) is a flexible, cost-efficient product package for actively managed strategies, but many different names, versions and understandings exist for it.

With this white paper, we endeavour to bring a better understanding of AMCs and the related business opportunities to the reader.

This white paper provides greater clarity while highlighting opportunities to a broader audience, from structured product issuers to asset managers and investors.

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Introduction

Over the past decade, there has been a growing trend towards pooling assets to reduce costs. This approach has led to a high degree of correlation among assets. But investors want personalized investment solutions. This trend is similar to that seen in the media industry when only a few TV channels were available, but now there are more personalized options such as Netflix and Spotify.

The desire to achieve customized investment exposure is often the impetus behind many financial product innovations. Financial product providers make considerable efforts to meet clients' expectations by introducing new and innovative products. Nevertheless, innovating in regulated industries such as the financial markets can be challenging. It requires a deep commitment for creating better financial products and a willingness to go above and beyond to overcome obstacles.

Traditional active investment strategies are often packaged as collective investment schemes, but these have high entry barriers such as large initial capital investments and regulatory hurdles. As a result, new forms of structured and collateralized investment solutions have emerged. One such product that has taken off due to innovation and digitalization in the field of structured products is the Actively Managed Certificate (AMC). Asset managers are increasingly drawn to AMCs for their simplicity, flexibility, and customization, making them a popular choice for active investment management.

We have compiled a summary of this popular type of structured product for asset managers and institutions considering the flexible path of active investment management and existing players who already use AMCs. This summary includes information on its structures and mechanics, as well as its advantages and disadvantages.



DEFINITION

What are Actively Managed Certificates (AMCs)?

Actively Managed Certificates (AMCs) can be defined as structured products whose underlying strategy, respectively, strategy-components are adjusted over the course of their term at the discretion of a strategy-manager. The strategy's performance is tracked by calculating the value of a synthetical strategy-basket or tailor-made index that consists of individual notional strategy-components which are actively selected and adjusted in compliance with the parameters of the specific product idea¹.

AMCs offer a swift, adaptable, and cost-effective method of accessing dynamic investment strategies. Investors can quickly convert their investment strategy into a transferable security, with the option of linking it to traditional securities, as well as non-bankable assets like real estate, loan portfolios, collectables, and digital assets.

¹ Luca Bianchi, The Rise of Actively Managed Certificates, CapLaw 2/2015, 23.

These certificates are issued as debt securities by banks, securities dealers, or special purpose vehicles (SPVs). They are offered either publicly or privately, with the option (or regulatory requirement for retail products offered in Switzerland) of being guaranteed or collateralized. In Switzerland and many other jurisdictions, AMCs are qualified as structured products. An investment manager selects and adjusts the underlying assets dynamically or according to a pre-defined index rule.

AMCs have gained widespread popularity among investment managers looking to fulfil their client's needs quickly and flexibly in terms of investment strategies and asset classes.



To-mae-to, to-mah-to: One instrument, different names

In the regulated financial industry, AMCs must comply with national and international financial market regulations, especially with respect to cross-border offers. AMCs offer a high level of customization and potential returns. These certificates can also be known by several other names, such as Dynamic Equity Notes, Strategy Notes, Actively Managed Trackers, Exchange Traded Notes (ETN), or Exchange Traded Products (ETP), with each term highlighting different aspects of their versatile nature:

Actively Managed Certificates

also known as

Strategy Index Certificates

Dynamic Equity Note

Strategy Notes

Actively Managed Trackers

Strategic Index Certificates

Exchange Traded Notes (ETN)

Exchange Traded Products (ETP)



AMC CLASSIFICATION

Types of AMCs

From (Passive) Derivatives to AMCs

Traditionally, derivatives, particularly structured products, were typically passively tied to underlying assets and had a fixed term. For instance, Delta One structured products provided a linear exposure to their underlying assets. However, AMCs are a structured product type that offers greater flexibility. In contrast to traditional structured products, AMCs' underlying strategy or strategy components are actively adjusted by a third party during their limited or unlimited term. The strategy's performance is tracked by calculating the value of a strategy basket or a tailor-made index, which consists of individual notional strategy components. These components are actively selected and adjusted in compliance with the specific product idea's parameters.

Market participants continuously develop multiple variations of the various AMC formats. Especially the growth in the alternative investments space drives the innovation of how AMCs are structured. There are three (selected) types of AMCs: on-balance sheet AMCs, off-balance sheet AMCs and tokenized AMCs.

On Balance Sheet AMCs

Classic AMCs are issued by banks or securities dealers of their own balance sheet. Usually, they have traditional capital markets instruments as underlyings, such as listed equities, bonds, derivatives, etc. Typically, the investor is exposed to the credit risk of the issuer. Credit protection via collateralization of AMCs can be applied. For example the Collateral Secured Instruments (COSI) or Triparty Collateral Management (TCM) solutions of SIX Swiss Exchange.

Off Balance Sheet AMCs

AMCs issued by a dedicated Special Purpose Vehicle (SPV) in principal do the same as on balance sheet AMCs but can be linked to alternative investments, such as private equity, private debt, digital assets (e.g. asset tokens, cryptocurrencies, or NFTs) or collectables in a more convenient manner. To protect the investor from the issuer's credit risk, SPVs issuing AMCs are set up with bankruptcy remote compartments in certain jurisdictions and/or are collateralized with COSI, TCM or other tailored collateralization solutions.

Tokenized AMCs

The tokenization of AMCs has emerged as a recent market trend. Distributed ledger technology (DLT) is utilised to transfer AMCs via blockchain, which is primarily fashionable for AMCs that involve investment strategies based on digital assets. However, in principle, both on-balance sheet and off-balance sheet AMCs can be tokenized.

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“AMCs are complex financial products which require sophisticated legal structuring.” – Luca Bianchi



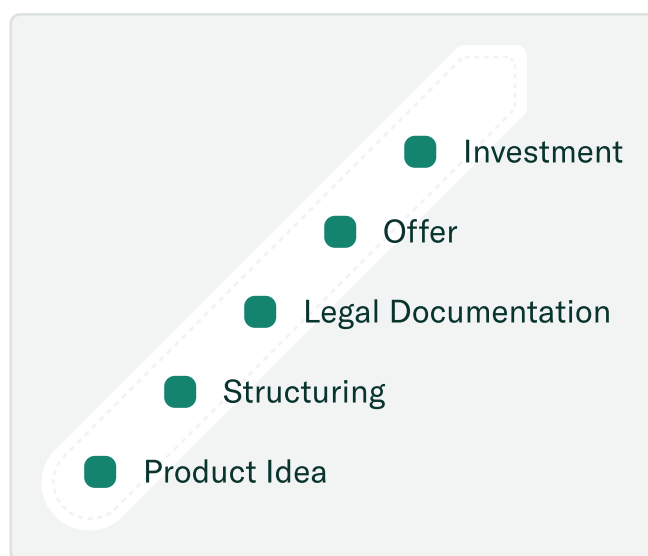


ISSUING & MANAGING AMCS

The Lifecycle of Actively Managed Certificates

AMCs have a lean issuance process

The legal structure for AMCs is created by structurers and/or issuers in accordance with regulatory requirements and the needs of the investment manager and the investor. Once the legal documentation has been created, AMCs can be issued very quickly.



- 01 The investment manager presents their investment idea to the AMC issuer/provider.
- 02 The AMC initiator and investment manager negotiate fees, costs, and service levels.
- 03 **Onboarding of investment manager by AMC issuer**
 - Regulatory status
 - AML (Anti Money Laundering)
 - KYC (Know Your Customer)
- 04 **Product documentation**
 - Legal offering documentation (prospectus, final terms)
 - Investment Management Agreement between AMC issuer and investment manager
 - Distribution agreement
 - Product factsheet
 - Strategy description (definition of permitted investment universe, investment rules, etc.)
 - Definition of fees and costs
 - Listing on exchange, if required
- 05 **Initial offer to investors during subscription period**
- 06 **First investment at the issue date (hedging)**



ONGOING ACTIVITIES

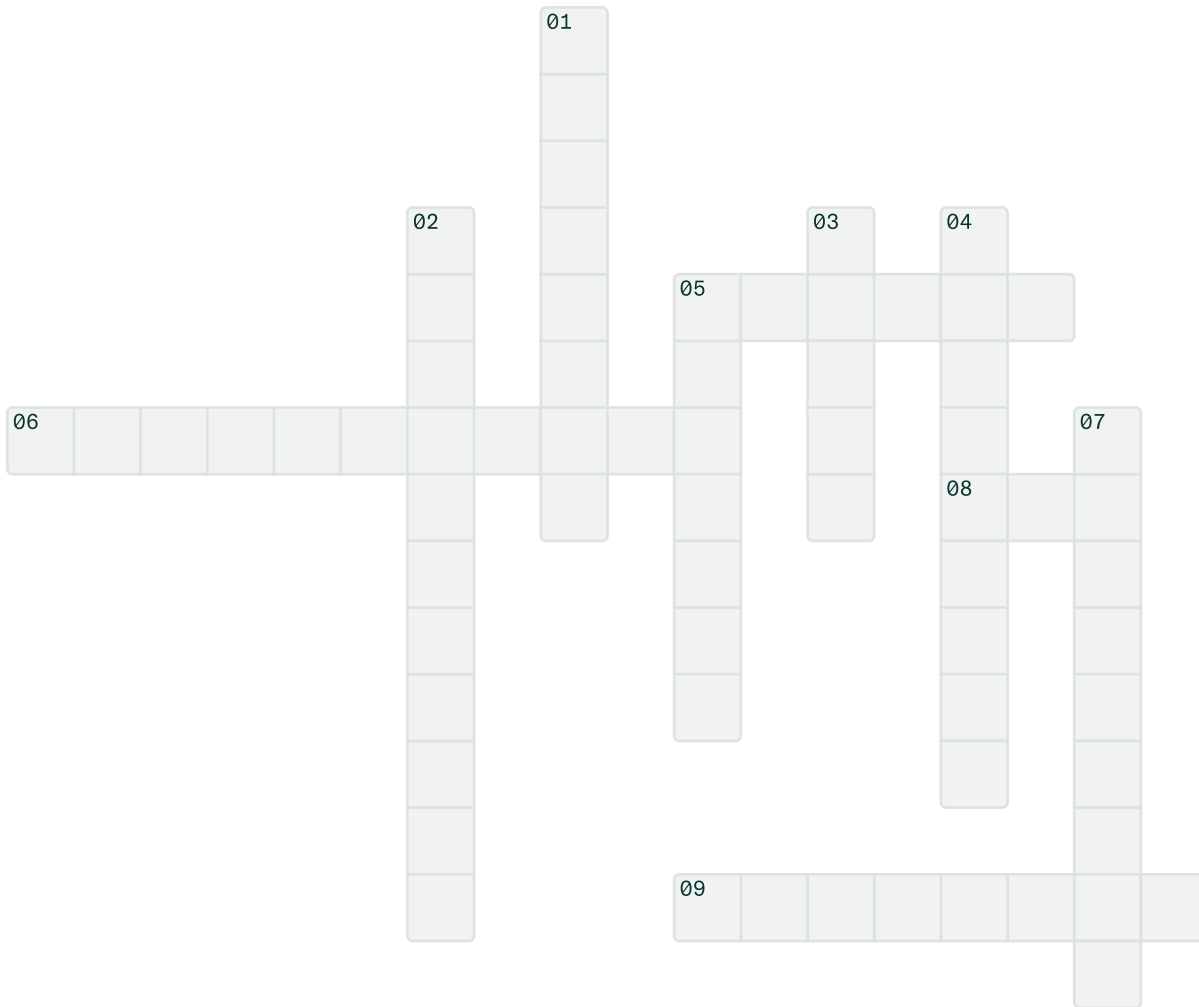
Mechanics of AMC-Asset Management

The AMC's strategy managers proactively manage the underlying assets of the product's basket in alignment with the strategy. One of the key advantages of using AMCs is that they enable the flexible launch of any investment strategy, whether the underlying is liquid or illiquid, in a structured products wrapper.

The strategy manager is compensated with a management fee for its services. For certain complex strategies, additional performance fees may apply.

Intra-day activities

- Investment instructions
- Pre- and post-trade checks of investment rules
- Hedging and execution
- Fee calculation
- Product valuation/ index calculation and publishing
- In/outflows
- Market making
- Investor reporting
- Performance reporting



Down

- 01 a sum of money paid regularly by a company to its shareholders
- 02 the act of changing a portfolios composition
- 03 an official inspection of an organization's accounts
- 04 a range of investments held by a person or organization
- 05 the protective care of something
- 07 telling investors how their investment is doing

Across

- 05 the annual interest rate paid on a bond
- 06 a limitation or restriction
- 08 a payment made in exchange for advice or services
- 09 a piece of written, printed, or electronic matter that provides information



COMPARISON OF AMCS AND FUNDS

Understanding the difference between AMCs and funds

AMCs and Funds are both financial products, but they have some key differences in terms of structure, regulation, and investor experience shown below:

Structure

AMC: AMCs are debt securities, respectively, structured products. AMCs can be exchange-traded products (ETPs) and be listed and traded on stock exchanges, similar to exchange-traded funds (ETFs).

Funds: Funds, such as mutual funds or hedge funds, are pooled investments with various structures, including open-end or closed-end funds.

Transparency

AMC: AMCs often disclose their holdings on a daily basis, offering a high level of transparency to investors. This allows investors to see the underlying assets and their performance.

Funds: Mutual funds are required to disclose their holdings periodically, usually quarterly.

Cost

AMC: AMCs which are structured correctly are not subject to collective investment schemes regulation in Switzerland and therefore generally have lower expense ratios than actively managed mutual funds.

Funds: Actively managed funds tend to have higher expense ratios due to the multiple additional costs that are not automated and outsourced to third parties. Plus, the extra time and effort it takes to obtain and maintain regulatory approval.

Regulation

AMC: Actively Managed Certificates: AMCs are regulated as structured products in most jurisdictions. When exchange-listed, they also must adhere to the regulations of the stock exchanges where they are listed. They are subject to disclosure requirements and investor protection measures.

Funds: Mutual funds are regulated by securities regulators, such as the Swiss Financial Market Supervisory Authority FINMA.

Trading

AMC: AMCs can be traded OTC (over the counter) or on stock exchanges throughout the trading day, allowing investors to buy or sell shares at market prices. Under normal market conditions (and with the support of a market maker, if available) they can be bought and sold like stocks and bonds, providing liquidity and flexibility. In the case of tokenized AMCs, peer-to-peer trading may be possible.

Funds: Mutual funds typically have a single daily net asset value (NAV) calculation, and transactions occur at the end of the trading day at the NAV price. Hedge funds often have specific liquidity terms and may have lock-up periods where investors cannot redeem their shares.

Important to note

The specific features and characteristics of AMCs and Funds may vary depending on the jurisdiction and the particular investment product. It is advisable to carefully review the offering documents and consult a professional financial advisor before making any investment decisions.



REGULATION

How the Regulator classifies AMCs

In Switzerland, financial services and the offer of financial instruments are regulated by the Swiss Financial Services Act (FinSA). In principle, a prospectus (registration) duty applies for public offers of financial instruments (including AMCs) or their admission to trading on a trading venue (Art. 35 para. 1 FinSA). Exemptions thereof under Art. 36 para. 1 FinSA may apply (e.g. if the offer is addressed solely at investors classified as professional clients or to fewer than 500 investors). Further, where a complex financial instrument is offered to retail clients, its producer must produce a key information document (KID) (Art. 58 FinSA). Exempt offers (private placements) also require adequate product documentation for which, however, no registration is required in Switzerland.

Regulatory Compliance for Structured Products, including AMCs, in Switzerland

Structured products (including AMCs) may be offered in or from Switzerland to retail clients only if they are issued, guaranteed, or secured in an equivalent manner by: a bank, an insurance company, a securities firm or a foreign institution that is subject to equivalent

prudential supervision (Art. 70 para. 1 FinSA). Alternatively, the issuing of structured products to retail clients by SPVs is permitted if (i) these products are offered by financial intermediaries as defined in the Bank Act (BankA), the Financial Institutions Act (FinIA) and the Swiss Collective Investment Schemes Act (CISA), insurance companies, a foreign institution that is subject to equivalent supervision, and (ii) eligible collateral is provided (Art. 70 para. 2 FinSA).

Moreover, AMCs must be established in a regulatory compliant manner to not qualify as collective investment schemes under the CISA.

Regulatory Compliance for Structured Products, Including AMCs, outside of Switzerland

Outside of Switzerland, the (foreign) regulations of the jurisdictions of the domicile of the issuer and the target investors may apply. Such non-Swiss regulations are neither taken into consideration nor further elaborated herein. In practice, cross-border offers, and distribution of AMCs require regulatory and legal considerations in the countries of domicile of the issuer as well as in the country of domicile of the investors (for example, in the form of country selling restrictions in the prospectus).

Consequently, compliance with Swiss and international regulations must be ensured for every country in which an issuer, offeror, or investor is domiciled, which is particularly important and challenging for cross-border offers of structured products.



FINANCIAL INNOVATION

Conclusion and Outlook

Actively Managed Certificates offer solutions to various challenges associated with traditional investment funds for both investment managers and investors. These certificates benefit from the reputation and branding of on-balance sheet issuers, which lends them credibility regardless of their investment objective. The off-balance AMC wrapper further enables investment managers to offer alternative investment strategies linked to non-bankable assets, such as crypto, unsuitable for specific collective investment schemes.

The short time to market of AMCs enables financial intermediaries to successfully create customized products tailored to the current investor requirements as a strategic positioning approach.

The flexible AMC format allows investment managers to develop innovative strategies that give investors a broader, more diversified product offering.

In the future, platforms that allow for the lifecycle management of products will rise and connect issuers, portfolio managers and investors. Successful providers of regulatory compliant digital solutions will dominate the market and set the standards.

The cycle of setting up AMCs gets significantly shortened via digitization. As a result, the required starting volume by AMC issuers has been reduced from CHF 10 million to CHF 1 million.

In the past, off-balance sheet vehicles were primarily used for non-bankable assets such as cryptocurrencies or highly active algorithmic trading strategies. Today, an increasing number of off balance sheet providers are entering the market, including special purpose vehicles whose AMCs can be listed on exchanges, issuing certificates to both retail and professional investors. Exchange-listed products require near real-time valuations.

Investment banks with a strong history in QIS (Quantitative Investment Strategies) are expanding their offering to include AMCs linked to such strategies.

Contributing to the growth of the AMC market are wealth management channels such as private banking mandates and asset management to provide tactical asset allocation and thematic investing to their clients.

In particular, such investors are looking for more transparency about their AMC investment in the form of performance attribution and ESG reporting.

The demand for AMCs continues to grow in Switzerland and internationally as more and more markets start using the flexible AMC format.

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"It is amazing to witness the growth of the AMC segment and the innovation we have achieved in this area as an industry over the past decade" – Stefan Wagner



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Stefan started his career as a derivatives structurer in 1994 and established the European exotic options trading desk of a leading global bank. He ran one of the most active and consistently profitable equity option trading teams globally. Later, Stefan ran the bank's EMEA structured products business, where he developed a range of investment products and funds. Over \$50 billion of these investments were successfully placed with high net worth and institutional clients. Before joining vestr, Stefan established a successful fund, specializing in derivative and value investing arbitrage strategies, before managing the global Delta One business, including AMCs, at a top-rated Swiss issuer of structured products. Stefan is an early-stage fintech investor and host of the Nalu FM Podcast.

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Crossword solution

