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Additional Information

Level 1 Regulation

Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Investor Protection and Intermediaries

Topic

Product governance

Subject Matter

Product governance

Question

Which considerations should manufacturers and distributors take into account when specifying the target market category “type of client to whom the product is targeted” for CoCo-Bond-Funds?

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Original language

[ESMA35-43-439 Investor protection Product governance Q&A1]

In ESMA's view, CoCo-Bond^[1]-Funds are generally not compatible with the retail market. ESMA believes that the investor protection concerns raised by CoCo-Bonds^[2] do also largely apply to funds which predominantly invest in CoCo-Bonds or use benchmarks which are predominantly composed of CoCo-Bonds. Therefore, ESMA expects manufacturers and distributors of CoCo-Bond-Funds to carefully scrutinize such products in the respective product approval process and assess the target market proportionally to the features and risks of the product. This assessment should also take into account the envisaged investment services for the product (e.g. in the course of an investment advice or portfolio management some of the above mentioned concerns could be mitigated). Manufacturers and distributors should therefore consider excluding retail investors from the positive target market or including retail clients in the negative target market. For CoCo-Bond-Funds already in the market, ESMA would expect manufacturers and distributors to take the abovementioned considerations into account in the next cycle of the product review process, at latest.

^[1] CoCo Bonds are highly complex, hybrid capital instruments with loss-absorbency features written into their contractual terms. One key characteristic is that they feature an equity conversion or writing down trigger, set with reference to the issuer's capital position in relation to regulatory requirements. CoCo Bonds are eligible towards issuers' Additional Tier 1 (AT1) capital and feature other unusual characteristics for non-equity instruments, in that they are permanent notes with entirely discretionary income payments. This means 'coupons' may be cancelled at any time, for any reason, and the notes may never be called. While CoCos can be designed in a range of different ways, all are highly complex instruments presenting investment risks that are exceptionally challenging to evaluate and model.

^[2] ESMA and the Joint Committee of the European Supervisors as well as several NCAs have already expressed their view that CoCo Bonds are inappropriate for distribution to ordinary retail investors as they raise several investor protection concerns (e.g. ESMA Statement on "Potential Risks Associated with Investing in Contingent Convertible Instruments" –ESMA/2014/944 – 31 July 2014 and JC Reminder on "Placement of financial instruments with depositors, retail investors and policy holders ("Self

placement')" – JC 2014 62 – 31 July 2014).