AUTORITÉ DES MARCHÉS FINANCIERS

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The AMF is updating its policy on the organisational and transparency rules applicable to management companies wishing to invest in or gain exposure to CoCos through their funds

Recognising the growing interest among asset managers in contingent convertible bonds, commonly known as CoCos, the AMF is updating its policy and clarifying the organisational and transparency rules applicable to management companies that want to invest in or gain exposure to these instruments.

Growth in CoCo debt markets over recent years has attracted asset managers because of the attractive returns and portfolio diversification possibilities offered by these securities. Issued by credit institutions, insurers or reinsurers, CoCos are subordinated debt securities that qualify as regulatory capital. A specific feature of these instruments is that if a pre-agreed trigger detailed in the prospectus occurs, they can be converted into equity or be subject to a principal writedown.

Since there is no harmonised structure for CoCos, and given the difficulty in assessing trigger thresholds and the losses to which investors are exposed, the AMF has decided to update its policy as follows:

- Regarding the classification of CoCos in the programme of operations of asset management companies, CoCos shall be treated as debt securities with embedded complex options, meaning that the company must perform specific due diligence tasks, notably in terms of risk monitoring.

- Regarding the organisation of the asset management company, the investment in or exposure to CoCos through the funds requires the management company to have a risk management function that is independent of the financial management function.

- If an undertaking for collective investment in transferable securities, a retail investment fund, a fund of alternative funds, or a professional investment fund has the option of being invested (no minimum amount) in CoCos, affected existing funds have until 31 December 2017 to comply with the new policy. The prospectus must mention specific related risks (notably conversion- or writedown-related risk if the issuer's equity falls below the trigger threshold).

Asset management companies have until 31 December 2017 to comply with the new policy by applying, if necessary, to extend their programme of operations to include the management of financial instruments with embedded complex derivatives and by setting up a risk management function that is independent of their financial management function. Otherwise, management companies must manage their exposure on a run-off basis, gradually disposing of positions in the interest of investors.

Affected management companies should contact their usual AMF portfolio manager to say which approach they plan to take and provide their timetable for compliance.

Read more

↘ ESMA statement issued on 31 July 2014, "Potential Risks Associated with Investing in Contingent Convertible Instruments"

↘ Joint statement by EBA, ESMA and EIOPA on 31 July 2014, "Placement of financial instruments with depositors, retail investors and policy holders"

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