

FCA on restriction of retail distribution of CoCos and mutual funds

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The FCA is proposing to put in place new requirements which would apply when mutual society shares are sold to ordinary retail investors and to tighten the rules around the sale of contingent convertible securities ('CoCos'). The FCA's decision is driven by the fact it says; that most investors are unaware of the risks associated with share instruments issued by mutual societies. These risks include the lack of liquidity, the fact dividend payments are not guaranteed and that there is a risk of partial or complete loss of capital if the issuer gets into financial difficulty.

The FCA is proposing that firms selling these investments will need to ensure the investor has read specified risk warnings and committed not to invest more than 5% of their net assets. These requirements apply only to sales to retail investors who have not been certified as sophisticated or high net worth.

In August, the FCA also announced temporary rules imposing a restriction on the retail distribution of CoCos, which will run for a year from 1 October 2014. The FCA is now consulting on proposed permanent rules, which are broadly the same as the temporary rules, but would also impose restrictions on funds of the securities. The FCA will continue to work with issuers in the interim, to ensure that the sale of these instruments are targeted appropriately.

CoCos differ to regular convertible bonds in that the likelihood of the bonds converting to equity is contingent on a specific event, such as the stock price of the company exceeding a particular level for a certain period of time. CoCos can yield around 6% or 7%, and have proved attractive to investors due to the low interest rate environment. However, Christopher Woolard, director of policy, risk and research at the FCA explains, "in a low interest rate environment many investors might be tempted by CoCos offering high headline returns. However, they are complex and can be highly risky, and the FCA has used its new powers to ensure that CoCos are not inappropriately made available to the mass retail market while still allowing access for experienced investors".

The FCA has therefore temporarily restricted their distribution only to professional, institutional and sophisticated or high net worth retail investors ahead of consulting on permanent rules later this year.

The consultation on the proposed new rules for mutual share societies and CoCos will run until 29 January 2015. Affected firms should therefore aim to respond to the consultation before this date.

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