Credit-linked notes allow investors to invest in the creditworthiness (credit quality) of a debtor (sovereign or corporate, hereinafter known as the “reference entity”). With credit-linked notes, interest payments and repayment are linked to the creditworthiness of the reference entity. If no credit event (such as bankruptcy, failure to pay or restructuring of payment obligations) impacts the reference entity, the investor receives interest payments and, upon maturity, the nominal value of the credit-linked notes. However, if a credit event occurs, the credit-linked notes are repaid prematurely. In this case, there are no further interest payments and the amount repaid can be significantly lower than the nominal value.

For retail business in Germany, the following principles summarise the practise developed in the investor’s interest with respect to the issue of and investment advice on credit-linked notes.

Principles for the issuance of credit-linked notes for distribution to retail clients in Germany

1. Only credit-linked notes with a simple structure are to be issued for the purpose of distribution to retail clients in Germany. These are first of all credit-linked notes that link interest payment and repayment to the non-occurrence of a credit event with a single reference entity. Credit-linked notes that link interest and repayment with the non-occurrence of a credit event with multiple reference entities are only issued if this achieves risk diversification for the retail client.
2. Credit-linked notes are issued with a fixed coupon only.
3. At the time of the issue of the credit-linked note, the shares or bonds of the reference entity are listed on an organised market within the meaning of Section 2 (5) of the German Securities Trading Act, ensuring that the reference entity is subject to extensive statutory disclosure requirements.
4. Reference entities are carefully selected, and should have a sufficiently good credit rating (“investment grade” or comparable) at the time of issuance of the credit-linked note.
5. Clients are provided with product information that comprehensibly describes the product structure and clearly indicates the risks, especially the contingency of interest payments and repayments on the non-occurrence of a credit event (together with an explanation of said credit event), as well as a concrete description of the consequences for the retail client of the occurrence of a credit event.
6. Credit-linked notes are distributed with the German designation of “bonitätsabhängige Schuldverschreibungen” only.[1] The DDV has updated its German product classification (the Derivatives League) accordingly.
7. Issuers may not issue credit-linked notes in order to transfer risks from loans granted by themselves or any associated companies. Upon the issuance of credit-linked notes, issuers will enter into one or more hedging transactions related thereto. Irrespective of this, the legal obligations arising from any general conflicts of interest need to be observed.
8. Credit-linked notes are issued with a minimum denomination of EUR 10,000.
9. When providing investment advice, credit-linked notes are not distributed to retail clients in the two lowest risk tolerance categories.
10. For the purpose of investor protection, as a first step in the distribution of credit-linked notes, particular consideration is given to the knowledge and experience of the investor with respect to the product structure of credit-linked notes. As a second step, investors are provided with additional product-specific information. In particular, investors are informed of which credit events relating to the reference entity can lead to (partial) non-payment of interest or nominal value. The risks are particularly highlighted in the documentation.

[1] The English designation remains “credit-linked notes”