



The capital markets recovery package

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In brief...

The European Commission introduced proposals containing adjustments to the prospectus, capital requirements and securitization regulations and MiFID II reflecting supportive measures as a response to the COVID-19 pandemic.

These proposals include (i) the proposed EU recovery prospectus to help raise capital for companies instead of going deeper into debt, (ii) reduced administrative burdens under MiFID II for European firms and (iii) the ability for banks to expand their lending and to free up their balance sheets from non-performing exposures by proposing amendments to the securitization and capital requirements regulations.

COVID 19 has had an immense impact on European businesses and the economy. The European Commission decided to find a suitable solution and develop an economic recovery strategy by proposing amendments to certain key regulatory frameworks. Therefore, further to the banking package proposal on 28 April 2020, the capital markets recovery package of 24 July 2020 marks four different proposals for regulations amending each of the below mentioned regulatory frameworks separately.

Proposal on securitization regulation (EU) 2017/2402 (Securitization Regulation) (Proposal 1)

Proposal 1 would amend the Securitization Regulation by allowing banks to expand their lending and free up their balance sheets from non performing exposures based on the European Banking Authority's (EBA) report on simple, transparent and standardized (STS) synthetics report (STS Synthetics Report) and the EBA's opinion on the regulatory treatment of non performing exposure (NPE) securitizations (NPE Opinion).

NPE SECURITIZATIONS

The NPE Opinion stated that current restrictions on bilateral sales, limit the market's capacity to absorb non performing assets from a bank's balance sheet.

Currently no special allowances are made for NPE securitizations enabling them to satisfy the risk retention requirement, in particular, no allowance is made for any price discount at which underlying assets could be transferred while representing an actual risk loss for investors. In addition, a special servicer in respect of a NPE securitization is currently not allowed to fulfil the risk retention requirement. Finally, the credit granting standards requirement does not cater for NPE securitizations.

Proposal 1 is seeking to introduce a definition of NPE securitizations and states that the risk retention requirement would be calculated on the basis of the discounted value of the exposures transferred to the securitization special purpose entity. Furthermore, it underlines that a servicer may have more interest than originators in the recovery of value reflecting

a better alignment of its interests with investors. Proposal 1 further states that a verification duty of originators would be necessary with respect to securitizations of non performing exposures.

STS BALANCE SHEET SYNTHETIC SECURITIZATIONS

Certain requirements for STS traditional securitizations do not apply to STS synthetic securitizations. Proposal 1 looks to create a framework for STS balance sheet synthetic securitizations that would benefit from a prudential treatment reflecting the actual risk under such instruments in order to also adapt the difference between the traditional and synthetic STS securitization. Additionally, Proposal 1 aims at specifying additional requirements to ensure that the STS framework would only target on balance sheet synthetic securitizations and clarify the structuring of credit protection agreements in favour of both, the investor and originator. It outlines specific requirements for STS on balance sheet securitizations in newly proposed articles 26(a) to 26(e) of the Securitization Regulation.

Proposal on the capital requirements regulation (EU) 575/2013 (CRR) (Proposal 2)

Proposal 2 provides a more risk sensitive treatment for STS on balance sheet securitizations and NPE securitizations.

NPE SECURITIZATIONS

Proposal 2 clarifies that the current risk drivers applied to NPE securitizations are disproportionate because senior tranches thereof are subject to larger risk weights than other tranches. It also lays out a specific framework by clarifying in a new article 269a that the senior tranche of a NPE securitization is then subject to a flat risk weight of 100% if the non refundable purchased price discount is at least 50% of the gross book value of the exposures. All other tranches thereof would be subject to a general framework and two requirements (floor of one hundred per cent applying to the risk weight and the use of the foundation internal ratings based approach parameters would be prohibited).

STS ON BALANCE SHEET SECURITIZATIONS

The STS criteria for STS on balance sheet securitizations follow the same structure as set out for existing STS criteria under a traditional non asset backed commercial program securitization. Proposal 2 asks for a targeted and limited in scope preferential treatment for the exposures under such transactions that focuses on a senior tranche by widening the range of underlying assets.

CREDIT RISK MITIGATION FOR SECURITIZATION PURPOSES

Proposal 2 requests the alignment of the credit risk mitigation rules applicable to securitization exposures to the general framework by applying a new article 294 (3) for eligible providers of unfunded credit protection listed in the CRR who shall have been assigned a credit assessment by a recognized external credit assessment institution which is credit quality step 3 or above.

Proposal on the markets in financial instruments directive (MiFID II) (Proposal 3)

Due to the high administrative burdens of MiFID II, Proposal 3 tries to lighten the documentation and disclosure requirements that are not in proportion to the corresponding increase in the investor protection. Additionally, Proposal 3 targets a hedging exemption regime and position limits. Differentiation is made between professional, eligible and retail clients accordingly.

INFORMATION REQUIREMENTS

Proposal 3 proposes the following items:

- documents could be provided in electronic format and retail clients could opt in to paper based information – this would release the cost burden put on banks and allow them to speed up the investment process;
- an exemption for eligible counterparties and professional clients from the disclosure of certain costs and charges – applying where services other than investment advice and portfolio management are concerned;
- a delayed transmission of cost information when using distant communication channels – ex ante costs disclosure is currently leading to delays in the execution of transactions and as a consequence, best execution clients providing their consent to a delayed transmission of such cost information documents are negatively impacted;
- an exemption for eligible counterparties and professional clients from receiving ex post statements from investment

firms on the services received – by providing an opt in option for professional clients, clients who want to receive such information can continue to choose this option or alternatively request more important information instead;

- where a costs benefit analysis of certain portfolio activities needs to be provided, including the switch of products, investment firms perform a suitability testing – facilitation of switching in order for professional clients to be exempted and having the possibility to opt into it;
- the product governance regime would no longer apply to bonds with make whole clauses as plain vanilla issuances are hindering the optimal allocation of capital.

FIELD OF COMMODITIES MARKET (EXCEPT AGRICULTURE)

Proposal 3 also amends the position limit regime that is currently affecting the liquidity in new commodity markets and proposes to limit the position limits to agricultural commodity derivatives or commodity derivatives designed as significant or critical as well as to delete the concept of "same contract" and replace it with a more cooperative approach between the competent authorities. Furthermore, Proposal 3 tries to reinforce the position management controls, introduce a narrowly defined hedging exemption, exclude securitized derivatives from the position limit regime and simplify the ancillary activity test.

Proposal on Regulation (EU) 2017/1129 (Prospectus Regulation) (Proposal 4)

Proposal 4 looks at changing the prospectus regime under the Prospectus Regulation in order to allow issuers to raise capital more quickly by introducing a temporary measure reflected in a new type of short form prospectus (an EU Recovery Prospectus) meant for the recovery period after COVID 19 and expiring 18 months after the entering into force of Proposal 4. It further introduces changes with respect to notifications of supplements and non equity issuances by credit institutions.

EU RECOVERY PROSPECTUS

Proposal 4 introduces simplified disclosure rules in order to support recapitalization through the EU Recovery Prospectus that would be available to secondary issuances of shares only. The cost saving through such EU Recovery Prospectus would benefit issuers which already have shares admitted to trading on a regulated market or an SME growth market for at least the last eighteen months. Not only the shortened approval period of five working days would allow issuers to raise capital quickly, but also the shortening of the EU Recovery Prospectus to thirty pages, allowing for an incorporation by reference of already available information in the market that are not required to be taken into account in the thirty pages.

SUPPLEMENTS

Proposal 4 also states that the publication of a supplement to a prospectus for any significant new factors, material mistakes or material inaccuracies with respect to the information included in the prospectus which would affect an assessment of securities, may lead to a withdrawal right for investors following such publication and obliges the financial intermediaries to inform the investors within the deadline prescribed. In order to avoid time difficulties arising therefrom, Proposal 4 stresses that the duty to inform only applies to investors which have purchased or subscribed to securities through such intermediaries. The latter remains subject to the agreement on the purchase or subscription during the period where the prospectus was approved and the closing of the offer period/ beginning of the trading on a regulated market, respectively. Proposal 4 extends the two working days period given to financial intermediaries to contact the investors to three working days from the publication of the supplement and also allows investors to exercise their withdrawal right within three instead of two working days as from the publication thereof.

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