Hogan Lovells

Debt Capital Markets – Global Insights

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Contents

Welcome

The debt capital markets in 2017 enjoyed a strong year in terms of issuance size and volume although this continues to be against a background of change, whether resulting from regulatory implementation, significant geo-political events in Asia, the United States and Europe or the use of technology and its application by participants, old and new, in our markets.

On the regulatory front, a number of the significant pieces of regulation arising from the financial crisis of 2008 – 9 have been, or are in the process of being, implemented, which has required a major effort across the industry to ensure deadlines are met with a prime example being the implementation of MiFID II in Europe and there is still some uncertainty as to exactly how implementation should take place. There is hope that we are now reaching the end of the process of major regulatory change, albeit the market is faced with new challenges such as Brexit and the discontinuation of LIBOR or other benchmarks and there is the residual question being asked by some, including regulators, as to whether the regulations which have been introduced come at a significant cost and need, in part, to be revisited.

As a practice, we follow these trends very closely and we take great care to listen to our clients and contacts – to understand the issues they face and how the industry is changing. This brochure reflects this dialogue and brings together a number of different perspectives from around the globe, looking not only at some of these issues and challenges but also the new opportunities which are available such as a boost for the non-performing loans market in Italy, the re-opening of the Brazilian equity markets to foreign investment and the new financing options which will be available for Mexican SMEs. New markets are developing and existing markets evolving, for instance in the FinTech space or with the launch of green bonds.

Our vision is to be a bold and distinctive law firm that creates valuable solutions for clients. We hope that this brochure illustrates our commitment to this vision and our engagement with the industry across the wide range of markets which we service.

James Doyle
Global Head of International Debt Capital Markets
T +44 20 7296 5849
james.doyle@hoganlovells.com

Discontinuation of LIBOR

How documentation in securitizations and other debt capital markets transactions is responding to the development

Issues

Market participants should not rely on the London Interbank Offered Rate (**LIBOR**) being available after 2021. That was the message delivered on 27 July 2017 by Andrew Bailey, chief executive of the United Kingdom Financial Conduct Authority (the **FCA**). This approach stems from the FCA's concern that it is potentially unsustainable and undesirable for market participants to rely on reference rates such as LIBOR that do not have active underlying markets to support them. Accordingly, the FCA proposes to transition to alternative reference rates that are firmly based on transactions.

LIBOR's administrator, ICE Benchmark Administration Ltd., has said that it intends to continue to produce LIBOR after 2021 because it believes that in accordance with the Wheatley reforms it has modified the index into a sustainable, modern part of the financial system. LIBOR's survival, however, cannot be guaranteed as the FCA has said that it will not compel or persuade LIBOR panel banks to continue to submit quotes after 2021 and so in practice they may be unlikely to do so.

There are three main issues that are thrown up by the planned discontinuation of LIBOR:

- what will replace LIBOR?
- how do current transactions in the market address the fact that LIBOR could potentially be discontinued during the term of the transactions?
- how do we deal with transactions that have already been entered into with maturities that extend to beyond 2021?

This article looks at each of these issues in turn.

What will replace LIBOR?

The long term issue is obviously the development of a robust and feasible alternative to LIBOR. Although there is no official definition of "robust", the International Swaps and Derivatives Association, Inc. (**ISDA**) has stated that it is important that any rate designed to replace LIBOR is not susceptible to manipulation and is based on liquid transactions.

The FCA has said that market participants should take primary responsibility for the development and transition to alternative reference rates, although it is ready to support and coordinate efforts. There is no replacement already available.

In the UK, in April 2017, the Bank of England Working Group on Sterling Risk-Free Reference Rates (which was set up to recommend a near risk-free reference rate and promote its adoption as an alternative to sterling LIBOR) selected SONIA as its proposed benchmark for use in sterling derivatives and relevant financial contracts. The group published a White Paper in June 2017 on the adoption of SONIA in sterling markets and sought feedback on the appropriate scope of adoption of the risk free rate across broader financial markets beyond derivatives, such as loan or bond markets and the substitution of SONIA into legacy contracts referencing LIBOR. SONIA is an overnight unsecured rate produced by the Bank of England, backward looking and fixed daily so it will not reflect the dependence of rates on the term of a loan. On the other hand with LIBOR, a borrower knows the interest rate payable for the relevant period. The Bank of England is looking to develop SONIA for different terms – three, six and twelve months. However, no concrete steps have been taken in this regard.

In the US, in June, the Alternative Reference Rates Committee announced its choice of a broad US Treasuries repo financing rate as a replacement for USD LIBOR. It is worth noting that this rate is not yet being published.

The FCA notes that both of these benchmarks benefit from more active underlying markets than LIBOR and neither involves expert judgment although they are backward looking as they report the rate for past transactions.

ISDA has also been working on long-term alternatives to LIBOR (and indeed to other benchmark rates) for some time and has set up working groups to address the following:

- suggestion of a fallback rate, or if determined necessary, fallback rates and/or other fallback mechanisms, that would apply if LIBOR (or any other applicable interbank offered rate) is permanently discontinued;
- amendments to the ISDA 2006 Definitions to add selected fallbacks that would apply upon any such permanent discontinuation;
- development of a proposed plan to amend legacy contracts referencing the applicable interbank offered rates to include the amended definitions, including potential development of a protocol mechanism to facilitate multilateral amendments.

Given the inter-connectivity of the markets and the importance of ensuring matching cashflows between bonds and swaps, the bond market and other markets will need to be guided by the derivatives market to establish benchmark rates fall backs and alternatives. It is crucial that the relevant working groups consider the financial markets as a whole and the full spectrum of products utilizing benchmark rates as a reference rate when determining the appropriateness of alternative rates.

Given that the work on replacing LIBOR with a more robust, risk free rate which is less susceptible to manipulation is still ongoing and there is little clarity of what LIBOR will be replaced with, it is difficult for market participants to pre-judge the outcome of the on-going work on the risk-free rates to produce an interim or long-term rate as any alternative to LIBOR. Flexibility and ease of amendment in deal documents will therefore be critical.

European Benchmark Regulation

Separately, the EU Benchmark Regulation (Regulation (EU) 2016/1011) (the **BMR**) applied in the European Union from 1 January 2018. The BMR aims to provide a framework for benchmarks to be produced in a transparent and reliable manner. For a more detailed discussion of the BMR, please see the next article in this Global Insights brochure entitled "EU Benchmark Regulation: Is your transaction up to the mark?".

However, of interest is the requirement under Article 28(2) of the BMR pursuant to which supervised entities (regulated firms including EU credit institutions, investment firms, insurers or reinsurers, pension funds, AIFs, UCITS, central counterparties and trade repositories) must produce and maintain "robust written plans" detailing what they would do if a benchmark materially changes or ceases to be produced, which must be made available to their competent authority upon request and included in the relevant contractual documentation. The plans should, where feasible and appropriate, nominate one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided, indicating why such benchmarks would be suitable alternatives.

In addition, the BMR requires that, with effect from 1 January 2018, prospectuses published under the Prospectus Directive which relate to an offer of transferable securities that reference a benchmark, are required to include clear and prominent information stating whether the benchmark is provided by an administrator included in the ESMA register. Prospectuses approved prior to 1 January 2018 need to be updated by 1 January 2019. Supervised entities can continue to use "existing' benchmarks until 2020.

How do current transactions in the market address the fact that LIBOR could potentially be discontinued during the term of the transactions?

Until a robust alternative to LIBOR that works for the financial markets as a whole is put in place, parties will need to consider whether transactions with maturities beyond 2021 should include provisions addressing a potential scenario where LIBOR is discontinued on a permanent basis. Although there is currently no consistent market-wide approach, considerable efforts are being made in this regard. The interests of lenders in the loans market, investors in the debt capital markets and of market participants in derivatives (including interest rate swaps) will all need to be considered. Within specific markets, there are also divergent views on what a robust alternative to LIBOR could be – for instance in the loans market, regulated banks fund themselves differently to non-bank lenders, thereby resulting in differing cost of funds (and potentially, differing interests).

In the absence of any guidance and divergent approaches being considered to address the discontinuation of LIBOR, it is likely that transactions will continue to be based on LIBOR as documentation can be adapted only when market thinking is more developed (and this may vary from jurisdiction to jurisdiction).

In the meantime, documentation is being designed to provide flexibility to make amendments to interest rate determination provisions that may be required as a result of the discontinuation of LIBOR.

Loans

Loan documents based on the current LMA forms and many U.S. forms typically have one or more fallback positions to cover a situation in which LIBOR is unavailable. In relation to their loan documentation, the LMA has said that it is too early to make any changes to the LIBOR wording in their standard forms. Accordingly, new transactions will continue to be based on the existing wording, including the fallback provisions. These include the standard "unavailability of screen rate" provision pursuant to which parties can choose to have recourse to the Reference Bank Rate and/or to lender actual cost of funds. One of the main issues with the fallback provisions under the LMA form loan documentation is that they have been developed primarily to address temporary unavailability of LIBOR. They are not designed for where LIBOR has been replaced by a totally different rate with a different methodology for calculation. Using the fallbacks as a long-term solution may be difficult and more costly to administer in the long term. It is also likely that Reference Banks would simply not provide quotes after LIBOR ceased to exist and the documentation would usually not compel them to do so. Mechanisms such as fallbacks to the last available LIBOR might result in a floating loans note being effectively converted into fixed rate loans, which is unlikely to be acceptable to lenders.

The LMA form loan documentation also includes an optional "Replacement of Screen Rate" clause, which is designed to make it easier for the parties to amend the facilities agreement to incorporate an alternative rate in place of LIBOR. The provision enables the loan documentation to be amended to incorporate an alternative rate provided that the borrower obtains the consent of the Majority Lenders to do so (as opposed to a more typical amendment clause which would require the consent of all lenders). The issue with this approach is that while it may facilitate the amendment being made, the provision may not be acceptable to all lenders on certain transactions as it would mean that fundamental changes in the loan's rate of return could be forced upon any minority lender.

One potential fallback that has been subject of extensive discussions is the introduction of a provision that, if LIBOR is unavailable, the reference rate will be the rate as determined by the lenders/agent. The concern that has been raised with this fallback is that it places too much discretion in the hands of the entity tasked with determining the alternative reference rate.

More recently, the LMA have announced that, with effect from 22 December 2017, they have updated their secondary trading documents, being their standard terms and conditions, the user's guide and the trade confirmations for bank debt, claims and risk participation to address the discontinuance of LIBOR. The definition of "Relevant Benchmark Rate" (used for the purposes of calculating the Relevant Rate in respect of the cost of carry element of Delayed Settlement Compensation and the sell-out element of the buy-in/sell-out provisions) has been amended to include, where the specified screen rate is not available and where it is not possible to calculate the interpolated rate, any rate specified by the Seller, acting reasonably.

It remains to be seen how the difference in approach between the loan documentation and the secondary trading documentation will be dealt with.

Debt Capital Markets

The discontinuation of LIBOR could potentially have implications for all types of debt capital markets transactions including bonds and securitizations. While long term floating rate notes are not very common in the plain vanilla bond markets (most have between 18 months to 3 years maturity), they are more common in bank and insurance regulatory capital issuances, corporate hybrid issuances and securitization transactions.

Bonds

Though, unlike ISDA or LMA documentation, there is no "master" or "standard" form for terms and conditions of notes in the bond market, the terms and conditions of most bond documentation typically contain limited fallback options if LIBOR is unavailable. These are (i) screen rate determination (if the relevant screen rate comprising LIBOR is not available, the provisions provide for a successor or replacement screen, an alternative fallback to rates to be determined by a number of reference banks who lend in the relevant interbank market and an eventual fallback to rates determined at the discretion of a given party (typically the cash manager or the calculation agent)) and (ii) ISDA determination (which typically refers to calculation on the same basis as the floating rate leg for an interest rate swap for the relevant designated maturity determined by the calculation agent on the basis of ISDA definitions).

While prospectuses and offering documents in plain vanilla bond transactions have begun to include a risk factor relating to the discontinuation of LIBOR, in the absence of any certainty as to when LIBOR will be discontinued and what rate will replace it, the approach is very much to "wait and watch" until further clarity is achieved in this regard and no provisions are being included in the bond documentation itself to address the likelihood or LIBOR being discontinued.

Securitizations

In relation to securitization transactions, it is becoming increasingly common for bond documentation to include provisions that will allow the parties to make amendments to the interest rate determination provisions if LIBOR is discontinued. Recognising that amendments to bond documentation could be time consuming and expensive (due to the nature of the consents provisions typically included in securitization transactions), provisions are now being included in documentation to "simplify" the consent process in circumstances where the issuer proposes to amend the reference rate. The simpler process requires the note trustee to agree to amendments to the reference rate (and other amendments which are necessary or advisable to facilitate such change) without the consent of noteholders or other secured creditors if the note trustee is provided with a certificate by or on behalf of the relevant issuer that the amendment is being made solely for the purposes of enabling the issuer to amend the reference rate. In order to provide maximum flexibility and permit issuers to carry out the amendments in good time before any discontinuation kicks in, the trigger for the issuers to request that the note trustee consent to amendments to the reference rate is not the discontinuation *per se* of LIBOR but any steps that would indicate that LIBOR is likely to be discontinued. These include:

- a material disruption to LIBOR, a change in the methodology of calculating LIBOR which is adverse to the issuer or any noteholders or LIBOR ceasing to exist or be published
- the insolvency or cessation of business of the LIBOR administrator (in circumstances where no successor LIBOR administrator has been appointed)
- a public statement by the LIBOR administrator that it will cease publishing LIBOR permanently or indefinitely (in circumstances where no successor LIBOR administrator has been appointed that will continue publication of LIBOR)
- a public statement by the supervisor of the LIBOR administrator that LIBOR has been or will be permanently or indefinitely discontinued or will be changed in a manner which is adverse to the issuer or any noteholders
- a public statement by the supervisor of the LIBOR administrator that means LIBOR may no longer be used or that its use is subject to restrictions or adverse consequences
- the reasonable expectation of the issuer (or an entity such as the servicer or the cash manager on its behalf) that any of the events specified above will occur or exist within a specified time frame (typically six months) of the proposed effective date of such modification.

Given the considerable uncertainty around the nature of the reference rate that would replace LIBOR, the consent provisions also include parameters for determining a new reference rate. In recent transactions, the following have been included as potential alternative reference rates:

- any reference rate published, endorsed, approved or recognized by the Federal Reserve, the Bank of England, any regulator in the United States, the United Kingdom or the European Union or any stock exchange on which the Notes are listed or any relevant committee or other body established, sponsored or approved by any of the foregoing
- the SONIA or Broad Treasuries Repo Financing Rate (or any rate which is derived from, based upon or otherwise similar to either of the foregoing)
- a reference rate utilized in a material number of publicly listed new issues of asset backed floating rate notes denominated in the same currency
- a reference rate utilized in a publicly listed new issue of asset backed floating rate notes denominated in the same currency by the same originator or by another originator in the same group
- auch other reference rate as reasonably determined by the issuer (or an entity such as the servicer or the cash manager on its behalf).

The parties that will ultimately be affected if LIBOR or any other reference rate is unavailable would be the noteholders. In order to protect their rights, the noteholders have, in recent transactions, been given the right to veto any amendment relating to LIBOR by way of a "negative consent" provision. Under this provision, in order to veto the proposed amendment, noteholders representing at least a specified percentage (in most recent cases, this has been set at 10%) of the principal amount outstanding of the notes should have notified the relevant issuer that they do not consent to the proposed amendments. Approaches as to which class(es) of noteholders have the negative consent right vary from transaction to transaction. In certain transactions, the negative consent right has been given to the most senior class then outstanding and in other transactions (where the floating rate notes are not the most senior class) to either the class(es) of floating rate notes or class(es) of notes that rank senior to such affected class).

Any modification to the reference rate will also need to satisfy other conditions including consent of all parties to the transaction documents that are proposed to be amended and a confirmation from the rating agencies rating the notes that such amendments would not cause a downgrade of the rated notes, although rating agencies are often sensitive to such provisions.

Whilst the above provisions have been included in some recent securitization transactions, there is no consistent approach in new transactions and decisions to include the fallback language referred to above are being made on a case-by-case basis. The Association for Financial Markets in Europe (**AFME**) is in the process of producing model wording to address the modification of the reference rate on the lines of the clauses described above. The model wording is in draft form and remains to be agreed. It is clear that any model wording would need detailed consideration by various market participants and would need to address various issues including the following (some of which have been identified by AFME):

- in transactions that involve interest rate hedging relating to a floating rate, care should be taken to ensure that any amendments are followed through in the swap documentation so that there are no unhedged mismatches;

- any relevant asset-specific swaps will also need to be amended;
- where the transaction documentation involves definitions such as "basic terms modifications", "reserved matters" or similar formulations, the definitions of such terms should be expressed to exclude modifications to the reference rate made in accordance with the terms above;
- would it be sensible to introduce a put option for noteholders/call option for the issuer in case the reference rate modification cannot be agreed?
- if so, what should be the exact circumstances in which any such options can be used (e.g. only if there is no LIBOR screen rate and fallbacks have been followed to apply a fixed rate)?
- should there be a time limit for use of any such option after those circumstances exist?

In addition to the flexible amendment language described above, prospectuses and offering documents in relation to securitization transactions have also begun to include additional risk factor language in offering documents to highlight any risks arising as a result of the discontinuation of LIBOR.

Derivatives

As with debt capital market transactions, derivatives transactions are also likely to continue to refer, where relevant, to LIBOR until other options are more developed. ISDA has set up working groups to develop fallback provisions and consider what would constitute a permanent discontinuation of LIBOR or any other reference rates. ISDA is also looking to develop a protocol to provide for amendments to existing contracts for those that elect to adhere to the amendments. During the time that the fallbacks and the protocol are being developed, no language is currently being used in documentation to address the potential of LIBOR being discontinued.

A principal risk in relying on the short term solutions described above is that the entire market does not move to new fallbacks, resulting in different issuers/transactions/markets amending reference rate provisions at times or only some contracts move to new fallbacks. Therefore, it is essential that a "permanent discontinuance" is clearly defined. The various bodies working on fallback provisions will have to ensure that fallbacks put in place will be suitable for the entire market.

What about existing transactions?

In terms of legacy transactions that continue to reference LIBOR, market participants would need to evaluate the fallback provisions in agreements that refer to LIBOR and consider how to amend those agreements to specify a replacement reference rate when necessary.

As mentioned above, ISDA is looking to develop a protocol to provide for amendments to existing contracts for those that elect to adhere to the amendments.

Unlike in the derivatives market, changes to pre-existing bond terms and conditions and loan agreements cannot be made via a protocol mechanism. Amendments to legacy bond terms and conditions would typically require a liability management exercise such as a consent solicitation. In the case of loan agreements, each loan agreement may need to be amended and the borrower will need to meet the requisite lender consent threshold in order to make that change in accordance with the requirements of the loan documents.

Both the process relating to amendments of bond documents and loan agreements would be time consuming and expensive. The issuer/borrower will also run the risk of the requisite conditions for the amendments not being met. This may result in many legacy loans or bonds being prepaid or

refinanced in advance of the establishment of a new benchmark (which might also prove to be costly and time consuming) or these instruments reverting to a fixed rate equivalent to the last available LIBOR rate. An alternative mechanism could be some form of coordinated statutory measure in the main jurisdictions. It is difficult to assess, at this stage, what form the statutory measures (if any) can be put in place.

Next steps

Whilst it is clear that various industry bodies and market participants are being proactive in taking steps to address the discontinuation of LIBOR (and other benchmark rates), the processes have raised more questions than answers at this stage. Whilst any development of market standard approach to address the discontinuation will take some time, it is important that these issues are addressed in a manner that works for market participants across the various markets and recognizes the inter-connectivity between these markets.

Contacts

Julian Craughan
Partner, London
T +44 20 7296 5814
julian.craughan@hoganlovells.com

Aarti Rao
Senior Associate, London
T +44 20 7296 2274
aarti.rao@hoganlovells.com

EU Benchmark Regulation: Is your transaction up to the mark?

Key points

- the EU Benchmark Regulation is, as of January 1 2018, now in effect, applying to administrators, users and contributors to benchmarks;
- the Benchmark Regulation defines these terms widely, so a broad range of transaction parties may be affected by the changes;
- transaction parties must ensure that their transaction documents are compliant, specifically by creating contingency plans and implementing wording in relation to any benchmarks connected to a finance transaction;
- grandfathering provisions are limited in both scope and length, meaning that affected parties must now ensure that they are compliant with the Benchmark Regulation in their transactional work as soon as possible, especially as penalties for non-compliance can be severe.

Introduction

On 30 June 2016, the EU Benchmark Regulation[1] came into force, imposing new requirements on administrators, users and contributors to a wide range of interest rate, currency and securities commodity indices and reference prices in securitizations and structured finance transactions. The scope of the Benchmark Regulation is much broader than any existing EU framework and will affect activities and firms that use benchmarks, as well as those administering or contributing to benchmarks. Most of the provisions took effect from 1 January 2018 and are directly applicable to EU firms that are benchmark users, administrators or contributors, without the need for national implementing legislation.

Benchmarks are used to price transactions in a variety of financial instruments and services, both domestic and cross-border, and are relied upon as a standard to measure the performance of an investment or security. The accuracy and integrity of a benchmark's underlying data and methodology are therefore highly relevant to the stability of the financial markets.

The impetus behind the Benchmark Regulation is to ensure the reliability of benchmarks in the wake of manipulation of the Euro Interbank Offered Rate and other critical benchmarks. There was much lobbying as the Benchmark Regulation was developed, partly due to the significant effect that a more stringent regulatory regime would have on the financial industry.

Grandfathering provisions in the Benchmark Regulation are limited and existing documents may need to be updated, so it is essential that market participants who are affected ensure their compliance as soon as possible not only on future transactions, but existing ones as well.

Am I or my transaction subject to the Benchmark Regulation?

The scope of the Benchmark Regulation is deliberately broad in order to establish a preventative regulatory framework.

A 'benchmark' is widely defined as:

> *"any index by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument is determined or an index that is used to measure the performance of an investment fund with the purposes to track the return of such index or to define the asset allocation of a portfolio or to compute the performance fees."*

1 EU Regulation 2016/1011

An ‘index’ is further defined as any figure that is:

– published or made available to the public
– regularly determined (either wholly or partially) by the application of a formula or any other method of calculation, or an assessment where determination is based on the value of one or more underlying assets or prices (including estimated prices, actual or estimated interest rates, quotes and committed quotes or other values or surveys)

Under the Technical Advice published by the European Securities and Markets Authority (**ESMA**) in November 2016, an index is “made available to the public” if it is accessible to an “indeterminate number” of recipients. The key is that there will be an open group of recipients that could change in size and composition, regardless of whether this is a limited number of people or access is restricted by payment of a fee. Accordingly, even figures made available to investors in a specific instrument are caught, given that investors typically trade their financial instrument and the group of holders changes over time. An indeterminate group in this context could obtain access to the index.

In addition, where an investor can derive an index value from published differentials, values of financial instruments and investment funds, strike prices or coupons, that value should be considered available to the public – a position that caused controversy during consultation. In this respect, the Benchmark Regulation goes further than what is typically considered to be an index under existing domestic regulation.

ESMA has published a register of administrators and third country benchmarks for market users’ reference[2].

If I am subject to the new rules, why should I act now?

Transitional provisions will apply to existing benchmarks. ESMA has clarified that this will include all benchmarks in financial contracts or instruments that are in place on 1 January 2018, but has made no suggestion that this will extend to benchmarks pending authorisation. Accordingly, no benchmark can be created after 1 January 2018 until it has been authorized.

A supervised entity user (see below) may continue to use an unauthorized benchmark until January 2020 or, if an application for authorization is made and refused, until the date of such refusal. In addition, where the relevant national authority agrees that altering or ceasing a specific benchmark to fulfill the requirements of the Benchmark Regulation will result in a *force majeure* event or frustrate the terms of any financial instrument or contract, the benchmark may continue to be used under such instrument or contract until such time as is agreed by that authority.

However, prospectuses approved prior to 1 January 2018 must be updated by 1 January 2019. As such, for market users who are not ‘supervised entities’ and cannot benefit from the grandfathering provisions it is even more crucial to be compliant as soon as possible.

Regulators are continuing to work on transition issues from existing benchmarks with market participants through entities such as the Financial Conduct Authority (**FCA**)’s market-led working group on Sterling Risk-Free Rates and the European Central Bank (**ECB**)’s Working Group on Euro Risk-Free Rates. The FCA has also published a policy statement (PS17/28) setting out near-final rules to accompany the application of the Benchmark Regulation.

No time limit has been imposed for these grandfathering provisions, which is welcome.

2 https://www.esma.europa.eu/benchmarks-register

What does this specifically mean for structured finance and securitization transactions?

Issuers, originators and service providers of securitization and structured finance transactions must carefully consider their obligations as benchmark users under the Benchmark Regulation. The following issues are of note:

- under Article 29(2) of the Benchmark Regulation, issuers will need to include in prospectuses published under the Prospectus Directive or the Undertakings for Collective Investment in Transferable Securities Directive a "clear and prominent" statement (for which the International Capital Markets Association (**ICMA**) has provided a model wording example for prospectuses), on whether the benchmark being used for the issued financial instrument is provided by an administrator included on the ESMA register of benchmarks and administrators mentioned above;
- consideration may be required as to whether provisions should be included in transaction documentation to ensure that calculation agents, cash managers and other service providers (e.g. derivatives counterparties) comply with their obligations as benchmark users;
- when originating consumer credit and mortgage loans, appropriate due diligence and consideration may be required as to whether it is necessary to include representations in related transaction documentation to ensure that only eligible benchmarks are being used to determine the amounts owed by borrowers and to ensure that the underlying loan or mortgage agreement identifies the benchmark, its administrator and the potential implications for the borrower;

- consideration should also be given as to whether it is necessary to include disclosure (such as risk factors) in the related securitization prospectus, as well as representations and warranties in transaction documentation, to the effect that amounts owing under the underlying loans or mortgages are all determined using an eligible benchmark;
- under Article 28(2), where any of the transaction parties are supervised entity users, they must produce and maintain "robust written contingency plans" setting out the actions that they will take if a benchmark that they use materially changes or ceases to be produced. These contingency plans must be reflected in client-facing documents (including contracts entered into before 1 January 2018, where practicable and on a best-effort basis) and provided to the firm's regulator on request;
- these plans should, where feasible and appropriate, nominate one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided, indicating why such benchmarks would be suitable alternatives. In a securitization context, this could mean a supervised entity issuer including the 'robust written contingency plans' in the terms and conditions of the instrument, or a calculation agent in the agreement which appoints them;
- the International Organization of Securities Commissions (**IOSCO**) published a statement on 4 January 2018 setting out matters to consider in contingency planning and selecting an appropriate benchmark. Users should select benchmarks for their own current and future needs, and those of their clients, and consider how well a particular

benchmark meets those needs. In any case, users should periodically assess the appropriateness of a given benchmark. For contingency planning, sufficiently robust fallback provisions should be included involving, at least, one alternative or fallback rate as a substitute should the benchmark initially referenced become unavailable. Such fallback provisions should be put in place in new and, where possible, existing arrangements.

Am I a benchmark user? If so, what does that mean?

The obligations now placed on benchmark administrators, contributors and users will create a regime with much more stringent controls than those existing under national law.

Under the Benchmark Regulation, the concept of a benchmark user is widely drawn and encompasses anyone that:

- issues a financial instrument[3] that references a benchmark;
- determines the amount payable under a financial instrument or financial contracts, including certain consumer credit agreements and mortgages[4], by referencing a benchmark;
- is a party to a financial contract which references a benchmark;
- provides a borrowing rate calculated as a mark-up of a benchmark;
- measures the performance of an investment fund through an index.

While the Benchmark Regulation will affect all benchmark users, its obligations and restrictions apply only to users that are "supervised" entities, including:

- credit institutions;
- investment firms;
- insurers or reinsurers;
- pension funds;
- undertakings for collective investment in transferable securities;
- central counterparties;
- trade repositories.

Merely holding a financial instrument that references a benchmark does not constitute use of a benchmark. In the derivatives market, those affected may include supervised entities who issue or are party to financial instruments which reference an index.

Supervised entities may apply a benchmark only if it or its administrator appears on a register of eligible benchmarks maintained by ESMA. This register can include benchmarks provided by non-EU administrators which have satisfied the requirements for equivalence under the Benchmark Regulation.

These changes will have an impact on future issuances. The prohibition on using unauthorized benchmarks may limit both buy and sell-side activities by restricting the types of security that EU-supervised entities can respectively hold and issue. This may have a particular business impact on bank issuers of structured products.

3 For example, transferable securities which are traded or for which a request for admission has been made to trade on a regulated market or multilateral trading facility, or an organized trading facility. As the same definition as in MiFID II is used, it includes structured products, listed and exchange traded derivatives and over-the-counter derivative trades.

4 Credit agreements under Article 3(c) of Directive 2008/48/EC and Article 4(3) of Directive 2017/17/EU.

Why is it so important to comply?

National competent authorities now have the power to impose a range of penalties, including fines and non-financial penalties, for infringement of the Benchmark Regulation or failure to cooperate with an investigation. For instance, the authorities may:

- make cease and desist orders;
- order the disgorgement of gains arising through a breach;
- issue public warnings;
- the financial penalties for a breach of the requirements applicable to benchmark users are:
  - at least €500,000 for individuals;
  - the higher of either €1M or 10% of the total annual turnover for companies and other legal entities.

Member states may grant their competent authorities power to impose higher levels of penalties, or elect to impose no administrative penalties where an infringement is subject to criminal penalties under national law.

What is the goal of these reforms?

The Benchmark Regulation aims to establish a consistent and effective regime to address vulnerabilities and restore market confidence in indices used as financial benchmarks by:

- improving the governance and controls over the benchmark process;
- improving the quality of input data and methodologies;
- subjecting contributors to adequate governance controls;
- ensuring adequate protection for consumers and investors through greater transparency and rights of redress.

In effect, the Benchmark Regulation limits administrators' ability to set benchmarks using their own discretion, and prohibits the use in the European Union of unauthorized benchmarks, including those prepared by unregistered administrators outside the European Union. The aim is to ensure the robustness and reliability of benchmarks and benchmark determination, thereby strengthening trust in the financial markets. The framework also aims to give stakeholders transparency on how a benchmark is derived, enabling them to assess its representativeness, relevance and appropriateness for its intended use, and consequently to ensure a harmonized regime across the European Union, with no risk of divergence in scope and application

Non-EU benchmarks

Non-EU benchmarks can be authorized for use in the European Union by way of equivalence, recognition or endorsement, but in practice these methods will present challenges. For example, an equivalence decision is likely to be relevant only for a limited number of jurisdictions, which would not include the United States, and the ability to apply for recognition will exist only where such an equivalence determination is pending. The endorsement regime requires an endorsing EU administrator to take on direct responsibility for – and oversight of – the benchmark, meaning that it may be only non-EU affiliates that look to use this.

Non-EU administrators will also have little incentive to seek such authorization, particularly if they derive low licence revenues from the European Union.

Comment

Now that the Benchmark Regulation has taken effect, supervised entities in the securitization and structured finance market should start to identify which of their business lines are engaged in activities that may constitute the use of a benchmark and consider how this may affect operations – for example, when issuing securities or entering into derivatives contracts.

Market participants should aim to ensure compliance and determine whether administrators will continue to provide benchmarks, particularly where these are outside the European Union. ISDA has worked on this issue in cooperation with regulators and intends to publish an ISDA Benchmark Supplement this year detailing amendments to standard terms for certain products required to demonstrate compliance with Article 28(2).

As such, market users should continue to keep an eye on regulators and industry bodies who will provide more guidance as to best practices for maintaining Benchmark Regulation compliance over the next two years.

Contact

Reza Mulligan
Counsel, Paris, London
T +33 1 5367 4747
T +44 20 7296 2000
reza.mulligan@hoganlovells.com


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Impact of the MiFID II Product Governance Rules

Overview and background

One of the EU's most ambitious regulatory reforms that took effect from 3 January 2018 imposes a series of new requirements on investment services providers and manufacturers of financial instruments in the EU. Under the Markets in Financial Instruments Directive (**MiFID II**) a new product governance regime was introduced which sets out a high-level framework for manufacturers and distributors of financial instruments.

Since its implementation in November 2007, MiFID I has been the cornerstone of capital markets regulation in Europe. However, since its inception, not all benefits have been fed down to the end investor as envisaged. Thus, MiFID II, aiming to address the shortcomings of the original MiFID release, has been enacted with the objective of enhancing the level of investor protection by the way of requiring investment firms subject to MiFID II to take responsibility during all stages of the product lifecycle process, that products and related services are offered in the interest of end clients.

Product governance rules

One key area is the new product governance regime which has been enacted with the objective of ensuring that firms act in the best interests of their clients during all stages of the product lifecycle process. Areas which have caused much contention within the legislation are the definition of "target market", the new expansive obligations of the manufacturer and distributor, firms' obligation to disclose information about their product cycle process and how firms prevent conflicts of interests from adversely affecting their clients.

The new product governance rules, as laid down in Articles 16(3) and 24(2) of MiFID II as well as in Article 9 and 10 of the MiFID II Delegated Directive 2017/593, cover a broad range of topics, especially in terms of the development and placement of products. The guidelines are designed to act as a tool so firms can clearly and efficiently define, review and share target market information that is broadly in line with a common industry approach.

MiFID II commands incremental changes on EEA investment firms (**MiFID Firms**) when they manufacture and/or distribute financial instruments and structured deposits. Financial instruments include, but are not limited to, bonds, shares and derivative instruments. The product governance rules are only applicable to MiFID Firms; however, non-MiFID Firms are indirectly impacted (given that e.g. where a non-MiFID Firm manufactures a bond issue which includes sales in the EEA, the MiFID Firm needs to ensure that it obtains sufficient information about the bonds and the target market of such bonds from the non-MiFID Firm).

Key components to this framework are the obligation of robust processes for the design of financial products and services, the identification of target investors and the ongoing monitoring of distribution activities.

To ensure compliance with MiFID II obligations, MiFID Firms are required to take steps to identify at a sufficiently granular level a potential target market of investors for manufactured products and furthermore to ensure that the strategy for distribution of the financial instruments is compatible with the identified target market.

Scope of the MiFID II Framework

The MiFID II Delegated Directive separates MiFID Firms into two categories: manufacturers and distributors. The product governance rules apply to MiFID Firms when they create, develop, issue and/or design financial instruments or advise corporate issuers on the launch of new financial instruments (manufacturers). Manufacturers must undergo a product approval process and governance arrangements which address conflicts of interest, market integrity and potential threats to the underlying functioning and stability of financial markets. The performance of products should be subject to period review.

Distributors are defined as investment firms that offer or recommend financial instruments to clients; MiFID Firms that are joint lead managers in a bond issue are most likely both manufacturers and distributors (and therefore must comply with the requirements for both categories, although they may do this using a single process rather than duplicating their procedures) and any other MiFID Firms in the syndicate of underwriters offering or recommending the bonds are distributors for this purpose. Distributors determine the actual target market by either adopting the manufacturer's target market or refining it; hence, products are distributed to the proper market. They also have product governance controls in place to ensure that products and services they offer or recommend are compatible with the needs, characteristics and objectives of the identified target market. Moreover, they must comply with the regular MiFID disclosure and the suitability/appropriateness assessment.

Manufacturers need to take reasonable steps to provide distributors of instruments with appropriate information on the investment product and the product approval process, including necessary information on the identified target market and appropriate channels for distribution. In addition, as from 3 January 2018 co-manufacturers are required pursuant to Art. 9.8. of the MiFID II Delegated Directive to outline their mutual responsibilities in a written agreement. Therefore, MiFID Firms now usually include respective language in subscription agreements they enter into.

MiFID Firms are further required to comply with the product governance rules in an "appropriate and proportionate" way, by considering the nature of the investment product, the investment service and the target market of the product.

Product approval and other requirements

MiFID Firm manufacturers (and MiFID Firm distributors where a target market is not defined by the manufacturer) must have an approval process in place to identify the target market for a financial instrument and specify the type of client for whose needs, characteristics and objectives the financial instrument is compatible. The European Securities Markets Authority (**ESMA**) provides in its "Guidelines on MiFID II product governance requirements" that MiFID Firm manufacturers should use the following list of five categories when considering the potential target market for a financial instrument:

a) type of clients to whom the financial instrument is targeted (e.g. "retail client", "professional client"). knowledge about relevant elements (e.g. product type) and experience of clients in thematically related areas;

b) financial situation in terms of the ability to bear losses;

c) risk tolerance and compatibility of the risk/reward profile of the financial instrument with the target market; and

d) client's objectives and needs.

In addition to the target market assessment, MiFID Firm manufacturers must determine a distribution strategy which is consistent with the identified target market, including appropriate distribution channels.

Furthermore, manufacturers must review financial instruments on a regular basis, considering any event that could materially affect the potential risk to the identified target market, taking appropriate action including notifications of any changes to distributors or stopping further issuance of products. The management body must have effective control over the product governance process, relying on a compliance function to monitor the development and period review of product governance arrangements.

Outlook and final thoughts

MiFID Firms face crucial practical and logical challenges in complying with MiFID II. In particular, it will be difficult for MiFID Firms to execute wide-ranging target market review procedures, given the traditional bond market practice whereby issuers engage and remunerate underwriters for the initial issuance procedure only and bonds are typically traded in the secondary market by entities with no connection to the manufacturer.

In practice also the conclusion of the so called "co-manufacturing agreements" for syndicated bonds as well as securitization transactions has proven to be difficult as the way of communicating the target market differs across the EU Member States. We can only hope that after the first month after the entry in force and intensive discussions among market participants, market standards get established and the new products governance regime really helps to improve investor protection without disrupting issuance processes.

Contacts

Jochen Seitz
Partner, Frankfurt
T +49 151 7462 3673
jochen.seitz@hoganlovells.com

Anna Rogge, LL.M. (Wellington)
Senior Associate, Frankfurt
T +49 699 623 60
anna.rogge@hoganlovells.com

Changes to the Italian securitization law: A boost for the NPLs market

On 24 April 2017, the Italian Government issued Law Decree No. 50 – converted into law by Law No. 96 of 15 June 2017 – providing for, *inter alia*, amendments to Law No. 130/1999 (the **Italian Securitization Law**).

These amendments aim at facilitating the divestment of loans qualified as non-performing pursuant to the provisions of the Bank of Italy (**NPLs**) by banks and financial intermediaries enrolled in the register of Article 106 of Legislative Decree No. 385 of 1 September 1993 (**Registered Financial Intermediary**) that have their registered office in Italy.

In particular, the amended version of the Italian Securitization Law sets out a special framework providing for new operational tools that can be used in the context of a securitization of NPLs.

What are the new tools?

Grant of loans to the transferred debtors by the NPLs SPV

A special purpose vehicle purchasing the NPLs (**NPLs SPV**) can finance the transferred debtors. By granting new liquidity, the NPLs SPV improves the chances that the transferred receivables (i.e. the NPLs) will be eventually recovered.

The NPLs SPV may grant these loans only to transferred debtors who are not individuals or micro enterprises where:

- the borrowers are identified by banks or Registered Financial Intermediaries;
- the notes issued by the NPLs SPV to finance the granting of the loan are assigned to qualified investors only; and
- the bank or the Registered Financial Intermediary identifying the borrower retains a significant economic interest in the transaction (minimum of 5%) so that its interests are aligned with the interests of the securitization noteholders.

In the event that the NPLs SPV grants loans to the transferred debtors, the management of the transferred receivables and the loans granted must be carried out by a bank or a Registered Financial Intermediary.

Purchase of shareholdings of the transferred debtors by the NPLs SPV

In the context of restructuring plans agreed with the NPLs assignor, agreements executed pursuant to the Italian bankruptcy law, or similar agreements for the restructuring provided for by law, the NPLs SPV may also:

- purchase or underwrite shares, quotas and other equity instruments deriving from the conversion of the receivables of the assignor; and
- Grant loans to such debtors with the purpose of improving the chances of recovering the transferred receivables.

The funds deriving from such shares, quotas or equity instruments will be segregated and allocated exclusively to satisfy the rights of the securitization noteholders and support the costs of the securitization transaction.

In this case, the provisions of Italian law establishing the subordination of loans granted by shareholders do not apply. The NPLs SPV must entrust a suitable entity that has all the authorizations required by law with the management of the equity interests purchased and the loans granted as well as the relevant power to represent the NPLs SPV, in the sole interest of the investors of the relevant securitization transaction.

Purchase and management of the NPLs collaterals

Furthermore, in the context of a NPLs securitization, an additional special purpose vehicle (**Collateral SPV**) that has the exclusive corporate purpose of purchasing, managing and fostering any assets and rights granted as collateral of the transferred receivables (**NPLs Collateral**) may be established.

The funds deriving from the holding, management or disposal of the NPLs Collateral will be segregated and allocated exclusively to satisfy the rights of the securitization noteholders and support the costs of the securitization transaction.

In the event that – in addition to the NPLs Collateral – the Collateral SPV is also the assignee of the relevant financial lease contracts, it must be:

- consolidated in the balance sheet of a bank even if it is not part of a banking group;
- established for a particular securitization transaction only; and
- wound up once upon conclusion of the relevant securitization transaction.

In this case, the Collateral SPV will benefit from all the tax provisions applicable to the financial lease companies and from a favorable tax regime for the transfer of real estate properties.

Final thoughts

The new tools have been designed to boost the transfer and management of the NPLs through the securitization scheme and to reduce the burden of the NPLs on the Italian banking system. However, since the enactment of these amendments to the Italian Securitization Law, only one transaction has been made using the new provisions.

The Italian market players are therefore expecting additional amendments to further improve the impact of these tools (in particular for tax-efficiency purposes) and expand their application.

Contacts

Federico Del Monte
Partner, Milan
T +39 02 720 2521
federico.delmonte@hoganlovells.com

Corrado Fiscale
Partner, Milan
T +39 02 720 2521
corrado.fiscale@hoganlovells.com

Annalisa Feliciani
Counsel, Rome
T +39 06 675 8231
annalisa.feliciani@hoganlovells.com

Giulia Arenaccio
Counsel, Rome
T +39 06 675 8231
giulia.arenaccio@hoganlovells.com

Balancing regulation and innovation

The current thinking around the potential impact of Fintech on the resolution of financial institutions

Post-credit crisis: Desire for resolution planning and the rise of FinTech

One of the great lessons learned from the credit crisis was the need for resolution planning for financial institutions and the desire for competent authorities to be equipped with resolution powers that would assist with financial stability. In the aftermath of the credit crisis, new rules for bank resolution were put in place across the EU in the form of the Bank Recovery and Resolution Directive (**BRRD**). Since the entry into force of BRRD on 2 July 2014 the banking industry has been shaken up by the emergence of new platform business models and many new financial technology (**FinTech**) entrants which have the potential to transform further the provision of financial products and services. Fintech is defined by the Financial Stability Board (the **FSB**) on a working basis as *"technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services"*[1].

As a result, authorities in the EU and across the globe have begun to look at the impact of FinTech on the financial sector. This article focusses on the current thinking with regards the potential impact of FinTech on the resolution of financial institutions in the EU.

How are regulators responding to FinTech?

The rapid advance of FinTech is driving structural change in the financial sector. Whilst innovation in finance is not new, investment in technology and the pace of innovation have rapidly increased significantly over recent years.

In addition to providing better access to finance and greater operational efficiency and lower costs, Fintech could also help deepen and broaden the EU capital markets by integrating new business models through data driven solutions in investment intermediation and product distribution.

However, FinTech may also present challenges, such as cyber risks and regulatory and supervisory authorities face the challenge of continuously adjusting to these market developments.

In the EU, the European Banking Authority (**EBA**) is keen to contribute to the policy debate in this area given the potential influence of FinTech on its overall objective to maintain financial stability in the EU and safeguard the integrity, efficiency and orderly functioning of the banking sector. The EBA has produced a discussion paper on its approach to FinTech which highlights concerns with regards the influence of Fintech developments on the resolution of financial firms, as set out further below. In addition, the European Commission is working on an EU Action Plan on FinTech[2] which seeks to put in place supportive measures to ease the uptake of FinTech solutions and provide proactive measures designed to foster and stimulate new solutions and address risks that emerge. The aim is to harness rapid advances in technology to the benefit of the EU economy and foster a more competitive and innovative European financial sector.

At the international level, FinTech is a priority area for the G20 and the FSB is actively monitoring and assessing developments in FinTech.

1 http://www.fsb.org/what-we-do/policy-development/additional-policy-areas/monitoring-of-fintech/

2 https://www.eba.europa.eu/regulation-and-policy/other-topics/approach-to-financial-technology-fintech-/-/regulatory-activity/discussion-paper published on 4 August 2017

What are the EBA's concerns?

In its discussion paper, the EBA highlighted several concerns relating to the impact of FinTech on the resolution of financial firms, which are set out below.

More than half of the FinTech firms are not regulated under the EU regulatory regime

According to the EBA's preliminary findings, 31% of FinTech firms are not subject to any regulatory regime, 14% are subject to a national registration or authorization regime and the regulatory status of 8% of FinTech firms could not be identified. The EBA suggests that the divergent regulatory treatment of FinTech firms might need further investigation and that guidance could be provided to national supervisors to ensure more convergence between national regulatory regimes.

FinTech firms do not typically have resolution related requirements

Given that many FinTech firms are unregulated, resolution–related requirements on FinTech firms are not common. However, divergent practices are emerging across jurisdictions with regards the requirements for FinTech firms to have a resolution or recovery plan on the potential winding-up/pay-out and the continuity arrangements that must be in place.

Potential influence of FinTech firms on the resolvability of credit institutions

FinTech firms could have both a direct impact (by virtue of a credit institution being the shareholder or creditor of a FinTech firm) and an indirect impact (where FinTech firms enter the current market as competitors affecting profitability) on the resolvability of credit institutions.

The EBA notes that this will therefore require enhanced scrutiny in the near future.

Creation of innovative payment services may impact the execution of resolution

FinTech has led to the creation of innovative payment services developed particularly by credit institutions and through Target2[3]. Currently, the resolution of a failing credit institution must take place within very tight deadlines so that its resolution can take place over the weekend. The EBA raises concerns that the natural pause in payments that is currently available during the resolution weekend might disappear if payments happen in real time and continue during the resolution weekend, potentially leading to an outflow of deposits. This has implications for valuation and the extent to which resolution tools are used and may add another element to decisions around the timing of determining when an institution is failing or likely to fail.

Increased digitalization

Increased digitalization may also speed up the movement of deposits in a crisis situation, changing the behavioural patterns in relation to deposit runs.

Resolution powers may be difficult to apply to decentralized FinTech technologies such as Blockchain

Some FinTech technologies are based on decentralized technologies, such as Blockchain, which is a constantly growing chain of ordered information in which each block is linked to the previous block. The design physically cannot work with a single computer or point-of-connection. As the system cuts out the intermediary, it is questionable how the competent resolution authorities will be able to exercise their resolution powers to these new technologies if such technologies expand in the near future. It is also not clear how regulated firms that make use of such technologies will be able to ensure continuity of their business given that they are not able to control the system. Before FinTech firms are developed to be critical entities, they should be regulated by an adaptable legal framework to ensure that the relevant authorities have the required tools to control the financial system. Although blockchain technologies are still at an early stage, there are a number of challenges which need to be addressed to ensure operational and economic continuity during resolutions. On 1 February 2018, the European Commission launched the EU Blockchain Observatory Forum[4], which aims to monitor trends and developments and explore joint solutions and cross-border use cases over the next two years.

Does FinTech offer any opportunities for resolution planning?

The EBA acknowledges that FinTech may offer opportunities and facilitate meeting resolution objectives, for example by improving reporting and monitoring processes, thereby facilitating operational continuity.

3 Target2 is a payment system owned and operated by the Eurosystem that enables EU banks to process money transfers between each other in real time

4 http://europa.eu/rapid/press-release_IP-18-521_en.htm

Next steps

The EBA intends to examine further the impact that FinTech may have on resolution and resolution planning in order to determine what action, if any, should be taken. It remains to be seen whether, in the context of cryptocurrencies, regulated and unregulated FinTech firms would be required to take certain action in the event of a resolution.

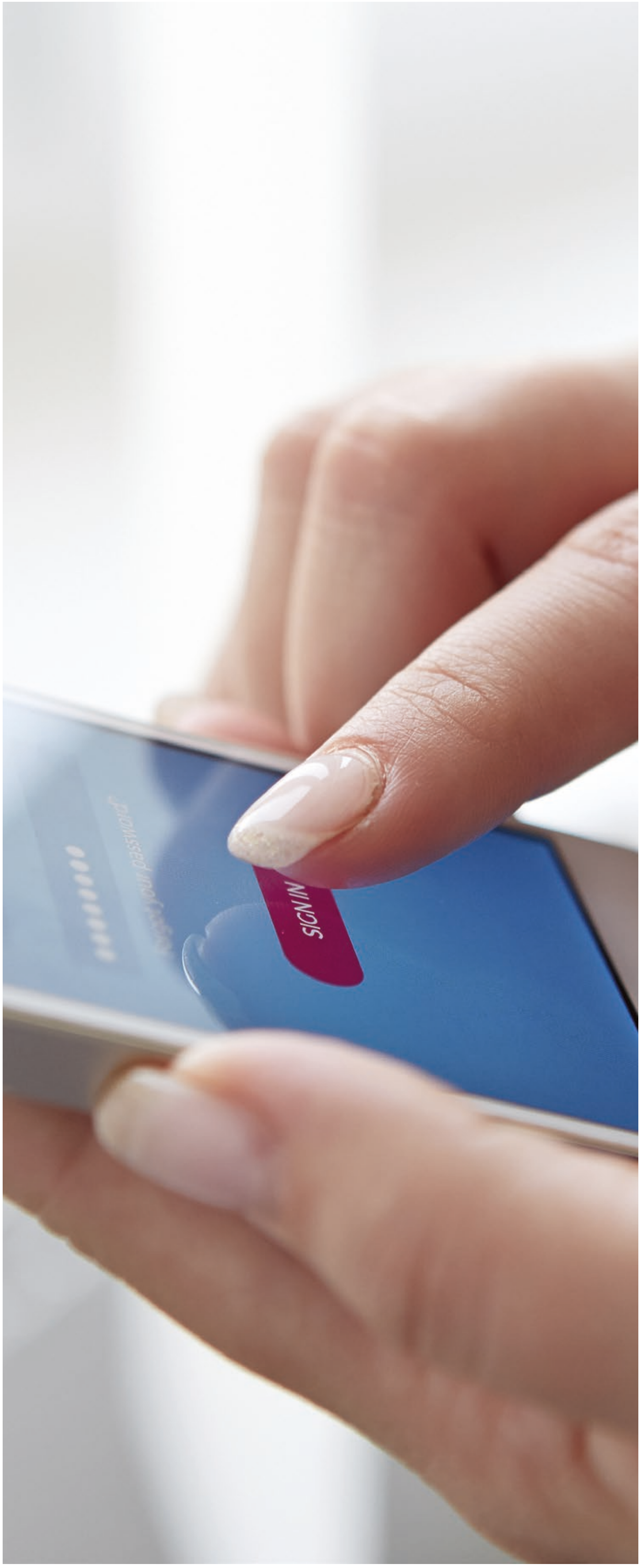
The draft EU FinTech Action Plan states that further careful analysis is needed to assess the extent to which the current financial services legal framework is able to accommodate the new FinTech advances and where it cannot, the rules should be adjusted accordingly. The European Commission is keen to encourage innovation in the financial sector whilst still ensuring that financial stability is preserved, which is a key pillar of regulation in the post financial crisis environment. Cooperation within the EU but also at the global level will be crucial to monitoring the continued development of FinTech technologies and any likely impact on particular areas of the financial system, such as the resolution of financial institutions.

Contacts

Robert Masman
Partner, Amsterdam
T + 31 20 55 33 747
robert.masman@hoganlovells.com

Isobel Wright
Counsel Knowledge Lawyer, London
T +44 20 7296 2610
isobel.wright@hoganlovells.com

Yvette Voermans
Junior Associate, Amsterdam
T +31 20 55 33 788
yvette.voermans@hoganlovells.com



New Sunshine Over Luxemburg – SOL

With the Securities Official List, the Luxemburg Stock Exchange is again at the forefront of innovation

On 12 January 2018 the Luxembourg Stock Exchange (**LuxSE**) launched the Securities Official List (**SOL**) which allows securities to be technically listed and displayed on its Official List (**Official List**) but without being admitted to trading. Such a listing will in particular be subject to light rules laid down in the Rulebook to the SOL which is available from 12 January 2018 on the LuxSE website (**Rulebook**)[1].

As of 12 January 2018, there are three different ways to list securities on the Official List of the LuxSE:

- a listing on the Official List with admission to trading on its regulated market;
- a listing on the Official List with admission to trading on the Euro MTF;
- a listing on SOL, the mere listing on the Official List without any admission to trading on any of the markets.

SOL provides those issuers which do not need or do not wish to have their securities admitted to trading on a market, or issuers which are restricted from admitting their securities to trading generally or in specific jurisdictions, to list their securities on an Official List within the European Union.

What could be the incentives and benefits of SOL?

Increased visibility of securities: An issuer would benefit from having its securities on public display on the Official List. SOL would therefore increase the visibility of the securities to a greater number of different types of investors. This may be of particular interest to an issuer that for various reasons is restricted from having its securities admitted to trading at all or outside its own jurisdiction. By listing on SOL, an issuer can create greater visibility of its securities and attract investors from other jurisdictions.

Possibility of providing indicative price: An issuer may provide an indicative price which will also be displayed on the Official List.

Limited ongoing disclosure obligations: There will be no on-going publication obligations under the Rulebook, and only very limited obligations to inform the LuxSE of certain events. The obligations deriving from transparency laws and the EU market abuse regulation (Regulation EU No 596/2014 of the European parliament and of the Council of 16 April 2014 on market abuse) are not applicable to a listing on SOL.

Outside of MiFID II requirements: Any reporting or other obligations, including under MIFID/MIFIR, which are triggered by an admission to trading on any regulated market or the Euro MTF, will not be applicable in relation to securities which are only listed on SOL.

Option to be displayed on the Luxembourg Green Exchange (if relevant): The listing on SOL opens up the opportunity to be displayed on the Luxembourg Green Exchange (**LGX**), provided the relevant securities comply with the LGX eligibility criteria. This will be of interest for issuers which have green bonds listed in their home jurisdiction, but may be restricted from admitting the green bonds to trading in another jurisdiction and hence, cannot access the LGX.

Lower listing costs: The costs for listing on SOL are lower than for a listing and admission to trading on the other markets operated by LuxSE. It will only consist of a one-off fee as set out below.

No clearing or settlement via clearing house required: No clearing or settlement via a clearinghouse is required. The Issuer must only provide an ISIN number for the securities to be listed on SOL.

1 as well as subject to the Grand-Ducal Regulation dated 13 July 2007 relating to the establishment of the official list and implementing the EU Directive 2001/34/CE.

No LEI needed: No legal entity identifier (LEI) for financial markets participants is required.

Approval by LuxSE within 3 business days: Applications for listing on SOL will be approved by the LuxSE and any such application will be dealt with within a maximum of three business days.

Increased visibility for fund sponsors: SOL bears a certain attractiveness for investment funds which typically refrain from a listing. A display on the Official List will increase visibility for fund sponsors and their products.

Other instruments may be permitted: Depending on the stance that the LuxSE will take, financial instruments which are strictly speaking not securities may be permitted to SOL. This could cover for example German law certificates of indebtedness (*Schuldscheine*) and other instruments which would typically not be admitted to trading on a market.

What documents will need to be provided for listing on SOL?

– the issuer will need to provide a light information notice (the so-called Information Notice) which contains basic information on the securities and the issuer. The Information Notice will have to be approved by the LuxSE. The content requirement for the Information Notice is laid down in the Rulebook The content of the Information Notice will be light. Not only the quantity of information to be provided in the Information Notice, but also the level of detail of information is less compared to what is required for any prospectus or offering document for an admission to trading on the regulated market or the Euro MTF. Financial information will need to be disclosed in the Information Notice, but with no on-going obligations to update such information or further disclose financial statements;

- where the securities have already been listed elsewhere and a prospectus has been approved by the relevant competent authority, no Information Notice is required. The LuxSE can rely on the approved prospectus and confirmation of approval by such competent authority, when provided to the LuxSE;
- the issuer will need to provide its constitutional documents and those of the guarantor (if any), as well as the annual reports of the last three financial years, where available. Where the issuer and/or the guarantor are companies which have just been set up the opening accounts should be sufficient;
- the issuer will have to provide a declaration and confirmation in respect of its compliance with the Rulebook, legislation and its articles, similar to the requirement for any admission to trading to any of the markets. Simple forms will be provided by the LuxSE on their website. This would also entail information on whether the securities are already listed and/or admitted to trading, that the securities comply with relevant legislation and that the administration of securities events and payments of dividends and coupons shall be ensured and be made correctly and in due time.

The LuxSE maintains a right to request any further information or document, it deems appropriate or necessary to protect investors and/or to ensure the proper operation of SOL.

What are the main obligations triggered by listing on SOL?

- the issuer will need to inform the LuxSE of any major changes, information and events likely to affect the securities listed on SOL or information deemed necessary to facilitate the due and proper operation of SOL. A non-exhaustive list is provided in the Rulebook which is very similar to the information requirements for any admission to trading on the markets of the LuxSE, and includes, for example, any amendments of the rights of the securities, announcement of distributions, redemption of debt securities before the due date, a name change of the issuer etc;
- all information that the issuer is required to make public also needs to be communicated to the LuxSE. This would include for example any change in its activities, amendment of its articles and notices of noteholder or shareholder meetings;
- the general rule of equal treatment of investors will also apply to SOL. This means that issuers will have to ensure equal treatment between shareholders, noteholders or unitholders (as applicable), which are in an identical situation as regards the securities listed on SOL.

What will be publicly displayed on SOL and the LuxSE website?

On the LuxSE website, basic information on the securities will be included, such as the ISIN number, the currency and the type of security. If provided, the price and price history will be displayed as well.

Any notices published via the LuxSE will be made available and remain on display. The Information Notice will also be available on the website of the LuxSE.

Contacts

Ariane Mehrshahi
Counsel, Luxembourg
T +352 26 4 26 123
ariane.mehrshahi@hoganlovells.com

Bob Scharfe
Senior Associate, Luxembourg
T +352 26 4 26 126
bob.scharfe@hoganlovells.com

The SEC proposes to modernize and simplify its disclosure requirements

Last October, the United States Securities and Exchange Commission (**SEC**) published for comment proposed amendments seeking to modernize and simplify certain disclosure requirements applicable to issuers that register securities for public offering in the United States or that are otherwise subject to the ongoing reporting requirements of the U.S. federal securities laws. Congress directed the review of such disclosure requirements in Section 72003 of the Fixing America's Surface Transportation Act (**the FAST Act**), a 2015 statute that required the SEC to prepare recommendations and propose rules aimed at improving "the readability and navigability of disclosure documents" and "modernizing and simplifying" the disclosure requirements "in a manner that reduces the costs and burdens on companies while still providing all material information." As required by the FAST Act, a report with the recommendations of the SEC staff was delivered to Congress on 23 November , 2016[1]; the new proposed rule, published in the Federal Register on 2 November , 2017, seeks to implement those staff recommendations that were found acceptable by the commissioners[2].

The proposed amendments affect several items of Regulation S-K (the regulation codifying the disclosure requirements applicable to U.S. domestic issuers) and several of the forms used to satisfy registration or reporting obligations under the U.S. federal securities laws. In particular, the proposed amendments would modify the following items of Regulation S-K:

– Item 102 (Description of property);

– Item 303 (Management's disclosure and analysis of financial condition and results of operations (**MD&A**));

– Items 401, 405 and 407 (Management, security holders and corporate governance).

In addition, the proposals amend rules governing (i) the presentation of certain information to be included in a registration statement or prospectus (items 501 (outside front cover page of the prospectus) and 503 (risk factors) of Regulation S-K), (ii) the filing of exhibits with the SEC (item 601 of Regulation S-K) and (iii) incorporation of information by reference into SEC filings.

The following is a summary of the proposed amendments:

Description of Property

As currently formulated, item 102 of Regulation S-K requires companies to "state briefly the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries." In response to the staff's conclusion that this formulation "often results in disclosure of immaterial information," the proposed amendments seek to clarify that the disclosure required by this item is only needed with respect to physical properties that are material to the company. This is sought to be accomplished by changing the language quoted above to read as follows: "To the extent material, disclose the location and general character of the registrant's principal physical properties." The point is further emphasized by adding the following language to instruction 1 to this item: "A registrant should engage in a comprehensive consideration of the materiality of its properties." Beyond this clarification, no substantive change to the requirement appears to be intended.

1 See "Report on Modernization and Simplification of Regulation S-K" (Nov. 23, 2016), available at: https://www.sec.gov/files/sec-fast-act-report-2016.pdf.

2 See FAST Act Modernization and Simplification of Regulation S-K, Securities Act Release No. 10,425, Exchange Act Release No. 81,851, Investment Advisers Act Release No. 4791, Investment Company Act Release No. 32,858, 82 Fed. Reg. 50,988 (proposed Nov. 2, 2017), available at https://www.gpo.gov/fdsys/pkg/FR-2017-11-02/pdf/2017-22374.pdf.

MD&A

The proposed amendments reject the staff's recommendation that when three-year financial statements are included in a filing the MD&A comparison of the earliest two periods should be substituted with a hyperlink to the prior electronic filing (**EDGAR**) where such discussion was included for the first time. They retain, in principle, the need for year-to-year comparison of the earlier periods, but allow discussion of the earliest year of three years to be omitted if (i) it is not material to an understanding of the company's financial condition, changes in financial condition and results of operations; and(ii) the company has filed on EDGAR a prior-year annual report on Form 10-K in which such discussion was included. The proposal would extend this change to foreign private issuers whose MD&A disclosure is governed by item 5 of Form 20-F (and not by item 303 of Regulation S-K).

Management, security holders and corporate governance

The proposal includes several technical amendments to the disclosure requirements regarding these matters as follows:

– amendments to item 401 of Regulation S-K to codify the staff's interpretive advice that seeks to eliminate ambiguities regarding the potential need for duplicative information in proxy statements and annual reports;

– amendments to rule 16a-3 under the Securities Exchange Act of 1934, as amended, to eliminate the need for delivery to the company of paper copies of certain reports filed with the SEC via EDGAR by its directors, executive officers and controlling persons regarding their holdings of company securities, and to item 405 of Regulation S-K to clarify to what extent the company may rely on a review of such EDGAR filings in preparing its own reports;

- amendments to update a reference to outdated auditing standards in item 407 of Regulation S-K;
- amendment to item 407 of Regulation S-K to clarify that emerging growth companies (generally, companies with less than US$1.07bn in gross revenues during the most recent fiscal year) do not need to include in their annual reports certain disclosure regarding involvement of the compensation committee in the compensation discussion and analysis section of the report.

Amendments regarding certain information to be presented in a registration statement or prospectus

The proposal includes the following minor amendments to rules governing certain information included in a registration statement or prospectus:

- elimination of the language in an instruction to item 501 of Regulation S-K which provides that when a company's name may create the possibility of confusion with another company, and if additional disclosure does not suffice to eliminate such possibility, the SEC may require a name change unless certain exceptions apply;
- amendment to allow information regarding how the price of the securities will be determined to be included at a location in the prospectus other than the cover page, provided a cross-reference to such location (including page number) is included on the cover page;
- amendment to item 501 of Regulation S-K to require the disclosure, in the case of securities not listed on a U.S. exchange, of the principal U.S. market(s) where the company, through the engagement of a registered broker-dealer, has sought and achieved quotation, together with the corresponding trading symbols;
- amendment to allow, in circumstances where state law does not prohibit the offering of the securities (for example, because state law is preempted by federal law), the removal from the red herring legend of the statement that "this prospectus is not an offer to sell the securities and it is not soliciting an offer to buy the securities in any state where offers or sales are not permitted";
- amendment to eliminate examples from the provisions in Regulation S-K that require risk factor disclosure. Following the staff's recommendation, the proposal eliminates the list of examples to eliminate the possibility that companies may feel compelled to address the risks described in such examples even if they do not apply to them. In addition, for technical reasons, the provisions governing risk factor disclosure are moved from item 503 to new item 105 of Regulation S-K;
- amendment to Rule 405 under the Securities Act of 1933, as amended, to define as "sub-underwriter" a dealer that is committed to purchase securities from an underwriter but is not in privity of contract with the issuer of the securities. The term is currently used, without being defined, in item 508(h) of Regulation S-K which, as part of the information regarding the plan of distribution of an offering, requires certain disclosure in the case of dealers that act as sub-underwriters;
- technical amendments to eliminate or update undertakings required by item 512 of Regulation S-K that have become obsolete or outdated.

Amendments regarding the filing of exhibits

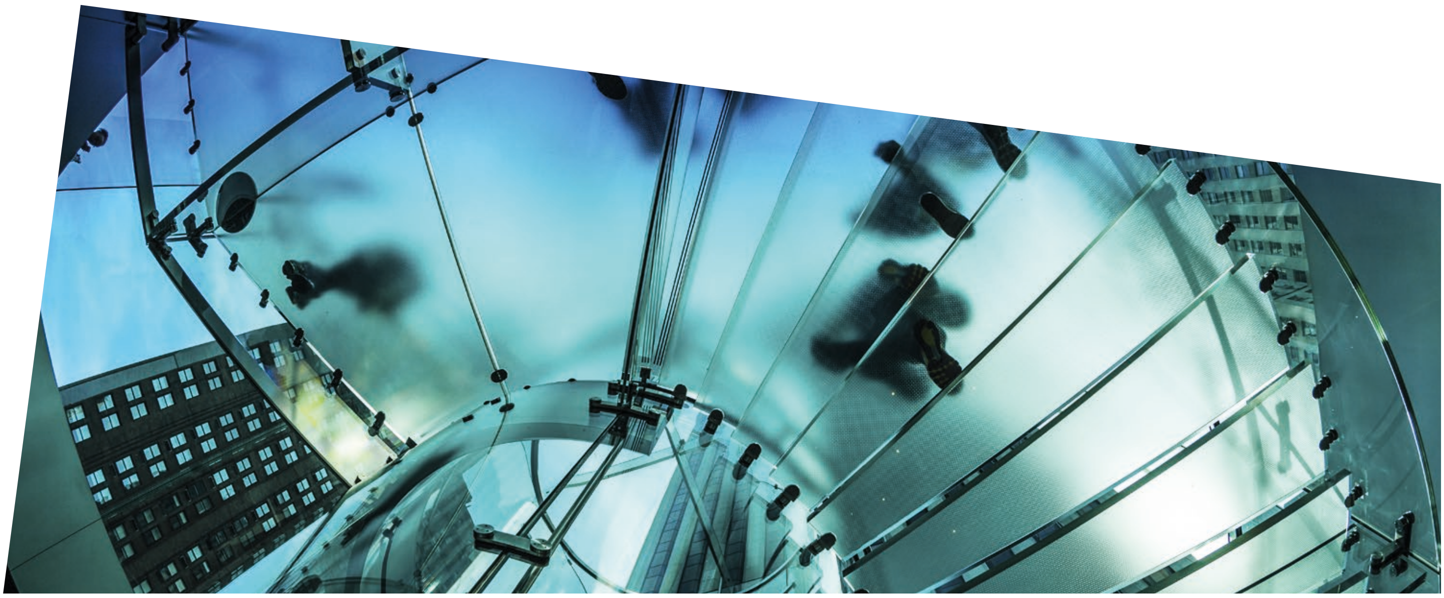
The proposal includes changes to item 601 of Regulation S-K that would:

- require the filing of an additional exhibit with information on each class of a company's securities with annual reports on Form 10-K;
- allow for the omission of schedules and other attachments to documents filed as exhibits (if not material to an investment decision and otherwise disclosed elsewhere) and the redactions of personally identifiable information;
- allow for the redaction from material contracts filed as exhibits, without the need for a request for confidential treatments (as it is currently the case), of information that is both (i) not material, and (ii) competitively harmful if publicly disclosed, provided that certain requirements are satisfied;
- limit the current requirement that companies file as an exhibit to a filing all material contracts not entered into in the ordinary course of business within the two-year period prior to the filing, even if fully performed before the filing date, only to "newly reporting registrants" (which is newly defined as companies that at the time of the filing are not subject to the ongoing reporting requirements of the U.S. federal securities laws and companies that have not filed an annual report since the revival of a previously suspended reporting obligation under such laws);
- require that the list of a company's subsidiaries include the legal entity identifier of each such subsidiary (if one has been obtained);
- the proposed amendments summarized above regarding exhibits would also be applicable to foreign private issuers the reporting requirements of which are governed by Form 20-F.

Incorporation by reference

The proposal seeks to modernize, consolidate and simplify the rules regarding incorporation by reference that are currently dispersed throughout several rules and forms adopted by the SEC under the different statutes it administers. Specifically, the proposed amendments would:

- eliminate provisions (such as the requirement that copies of certain information incorporated by reference be filed as exhibits, or the prohibition on incorporation by reference of information more than five years old) that originated at a time when some of the SEC archives were maintained in physical form



– require hyperlinks to information incorporated by reference into a filing, to the extent that the information so incorporated is available on EDGAR. To accommodate hyperlinks, such filings must be made in HTML format;
– clarify when and how corrections to hyperlinks erroneously filed should be handled;
– Unless expressly authorized by a rule or form, prohibit incorporation by reference of information outside of the financial statements into the financial statements included in a filing. (This provision was included at the request of auditing firms to eliminate ambiguities about what information is reviewed by the auditors in connection with the preparation of their audit reports).

XBRL tagging of cover page information

To enhance investors' ability to access, sort and analyze company information filed with the SEC, the proposal would require that all data presented on the cover page of periodic or current reports (including by foreign private issuers) be in machine-readable form using eXtensible Business Reporting Language (XBRL). In addition, the trading symbol of each class of securities traded on an exchange shall be also included on the cover page of the form.

Although the proposal's suggested changes to the current disclosure requirements, if adopted, would certainly simplify certain aspects of the preparation of companies' filings with the SEC, a comprehensive "modernization" of the disclosure regime would require substantial additional work. Even with the proposed amendments, the revised rules would continue to reflect their ancestral roots in a world in which the delivery of printed information was the only available alternative, and the conveyance of information by issuers to the SEC was critical in the assessment of what information has been provided, and when, to prospective investors. At a time when companies routinely communicate with different constituencies through a variety of means, including multiple social media avenues, it is clear that there is still room for substantial changes to the rules governing how information can be validly conveyed to prospective investors.

In addition, some of the proposed amendments may fail to achieve their objective. For example, if the omission from the MD&A of the comparison of the earliest two-year periods depends, in part, on a finding by the issuer that such comparison is "not material to an understanding of the registrant's financial conditions, changes in financial conditions and results of operations," it is to be expected that many companies, rather than undertaking the complex and time-consuming process involved in any type of materiality analysis, will opt for including the comparison in all filings.

Contacts

Patricia Ciccone
Senior Associate, New York
T +1 212 918 3247
patricia.ciccone@hoganlovells.com

Ann Choi
Associate, New York
T +1 212 918 5704
ann.choi@hoganlovells.com

Brazilian Equities

The re-opening of the Brazilian equity markets to foreign investment through increased IPO activity

Introduction

The year 2017 marked the return of new equity capital markets issuances by Brazilian companies, after several years of relative inactivity due, in part, to a number of political scandals that became public in 2014. The most notorious political scandal, known as *Lava Jato* (Car wash), which involves widespread corruption and ongoing investigations by Brazilian authorities, has had far reaching implications, leading to Brazil's worst recession in years [1]. The inflow of capital and investments from international investors into Brazil experienced a dramatic decrease from pre-scandal levels, as investors have waited for increased political stability and economic growth before investing large amounts of capital in the country. As a result, from 2014 to 2016, only three Brazilian companies (one per year) were able to access the capital markets by means of an IPO. Those three IPOs had an aggregate value of approximately US$570m[2].

Beginning in 2016, current president Michel Temer's economic team has sought to implement measures focusing on more effective management of public expenditures and budgetary restraints (with varying levels of success). Those measures have to some extent contributed to the recovery of investors' confidence in investing in Brazil, even in light of the on-going political scandals. This increase in confidence is evidenced by the recent flurry of IPO activity during the last year. There was a significant increase in IPOs listed on the São Paulo Stock Exchange – known as **B3**) in 2017– ten IPOs were successfully executed during the last year, raising an total aggregate amount of approximately US$6,476m (based on the current US Dollar / Brazilian *Real* exchange rate, as such transactions are executed in Brazilian *Reais*). There has also been increased issuance activity by existing Brazilian public companies. In 2017, Brazilian companies with securities already listed on B3 issued and sold additional equity securities (follow-on equity offerings) in an amount of approximately US$6,324m (based on the current US Dollar / Brazilian *Real* exchange rate).

In addition to the increase in the number of IPOs and follow-on equity offerings executed during 2017, indications are that high levels of activity should continue during the first half of 2018, as a number of other companies have filed or are intending to file issuer registration requests with the *Comissão de Valores Mobiliarios* (**CVM**), Brazilian regulatory authority equivalent to the U.S. Securities and Exchange Commission (**SEC**). While the expectation is that IPO activity will continue in 2018, upcoming federal elections in October 2018 could limit the window for such transactions.

Overview of the IPO process in Brazil

In Brazil, equity securities offerings are subject to a number of rules and regulations that have been enacted by the local regulators. According to CVM regulations, the local IPO process involves two registrations (one with respect to the registration of an issuer and one with respect to the equity securities to be registered). Both registrations can be, and normally are, filed simultaneously as a single request with the CVM. The CVM's review process usually takes approximately eight to ten weeks from the initial filing, allowing for two to three rounds of comments from the CVM.

Once the registration process has been initiated with the CVM, prospective issuers may start to produce

1 In 2015 and 2016 Brazilian GDP exhibited negative growth of 3.8% and 3.6%, respectively. Another two-year recession period has only happened once, in 1930 and 1931, and has exhibited negative GDP growth of 2.1% and 3.3%, respectively. (source: *Instituto Brasileiro de Geografia e Estatística* – IBGE)

2 Ouro Fino Saúde Animal Participações S.A. (ticker: OFSA3) in 2014; Wiz Soluções e Corretagem de Seguros S.A. (ticker: WIZS3) in 2015; and Centro de Imagem Diagnosticos S.A. (ticker: AALR3) in 2016.

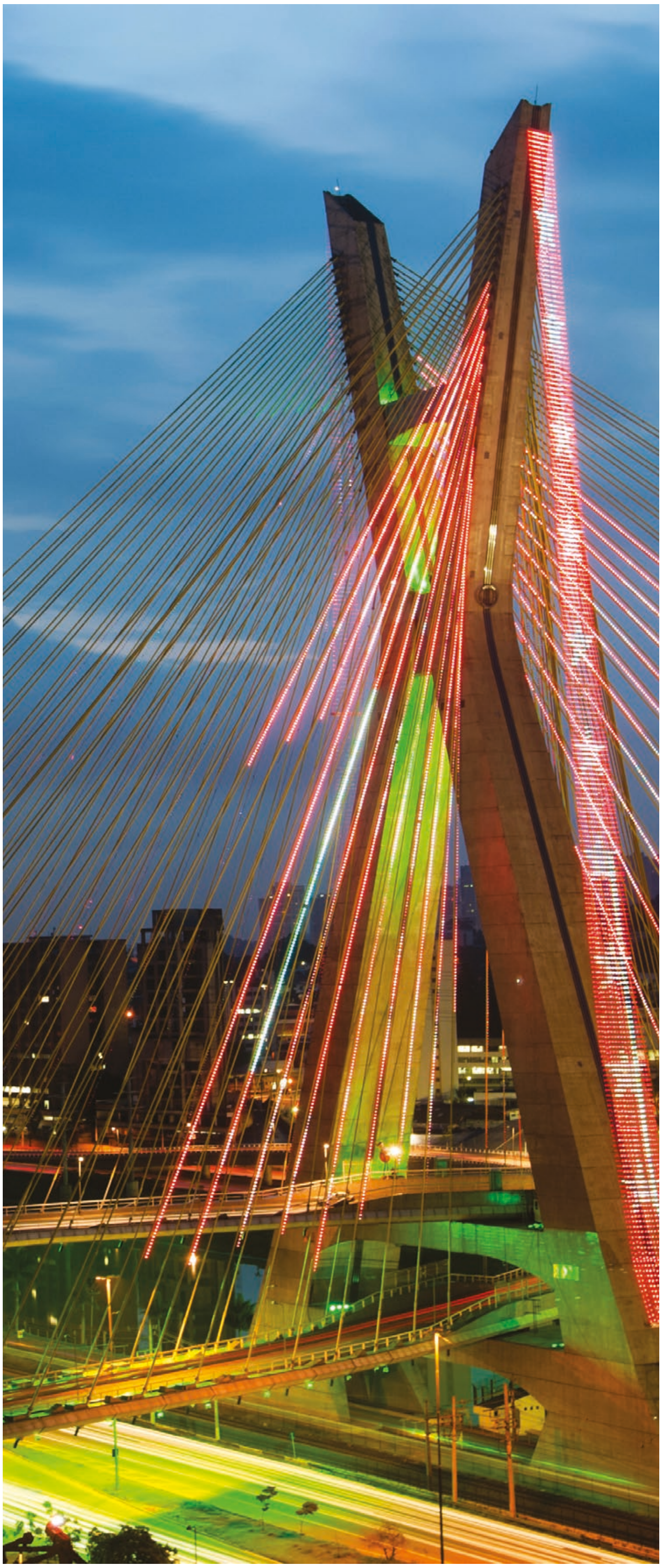
a preliminary prospectus and initiate marketing and book-building arrangements with respect to the contemplated IPO. However, a prospective issuer and the underwriters in an offering will typically wait until the first round of comments have been received from the CVM in order to have some level of confidence that there are no major regulatory impediments to pursuing the intended public equity offering.

Upon the grant of the registration of the offering by the CVM, the prospective issuer and the underwriters may proceed with announcing the transaction to the market and publishing and distributing the final offering disclosure on public websites. Such publication of disclosure sets the timeline for the beginning of the trading of shares on the B3.

From a U.S. law perspective, shares issued in a Brazilian IPO executed and listed on B3 are typically offered and sold in private placements utilizing the exemptions from registration under the U.S. Securities Act of 1933, as amended (**U.S. Securities Act**), such as those provided by Rule 144A of the U.S. Securities Act (**Rule 144A**) as well the exemption provided for non-U.S. persons under Regulation S of the U.S. Securities Act (**Regulation S**).

Selected Issues in Executing an IPO in Brazil

The IPO process for an issuer seeking a listing in Brazil is a complex process with a number of issues that must be considered in order to ensure the successful execution of the contemplated transaction. The following is a high-level discussion of a few of the more critical sets of issues to be considered.



Disclosure

Further to the earlier discussion regarding the local filing requirements, Brazilian securities laws require that an offering prospectus containing the terms of the securities in question and related matters (*prospecto*) and disclosure document regarding the issuer (*Formulário de Referência*) be filed with the CVM. The content and format of this disclosure is governed by a fulsome set of rules and regulations. One such key requirement is that the documentation must be in written in Portuguese. Brazilian qualified lawyers prepare the local offering disclosure and other documents needed for filing with the CVM and otherwise executing the local offering (offering to investors in Brazil), with the input of the other parties to the transaction, which include underwriters as well as lawyers retained for the international leg of the IPO (which are typically U.S. qualified lawyers).

The sale of securities to investors outside of Brazil are typically made pursuant to the exemptions to registration under the U.S. federal securities laws pursuant to Rule 144A as well as applicable provisions in other jurisdictions. While Rule 144A does not contain specific disclosure requirements (as would be the case for an offering registered with the SEC under the U.S. federal securities laws), market practice and general U.S. anti-fraud considerations have developed to the effect that U.S. investors in offerings made pursuant to Rule 144A expect disclosure standards similar to what would otherwise be required were the transaction to be registered. As such, the relevant SEC disclosure standards are used as guidance by U.S. counsel in preparing the offering documents (with some exceptions).

Difficulties arise when preparing the Portuguese language local offering disclosure for purposes of the requisite CVM filings and English language offering disclosure to be used in connection with the offer and sale of securities to investors outside of Brazil. The two sets of disclosure have to mirror each other in terms of substance, as investors must be provided with the same level of information on which to base an investment decision [in both languages]. A mismatch between the information disclosed in the local offering disclosure and in the international offering disclosure could open up the parties to an IPO to legal proceedings from investors and in some instances, enforcement actions by regulators. In order to mitigate this risk, the drafting processes with respect to the local offering disclosure (in Portuguese) and of the offering circular for the international offering (in English) must be carefully managed by the parties to a transaction. In practice, the parties involved in the IPO transaction discuss, negotiate, and work in the documents used in the local offering and once the transaction progresses and filings have been made with the CVM, the international transaction documentation is drafted to reflect the negotiated terms and disclosure.

Equity Research Reports

While equity research reports are a common feature in offerings of equity securities by issuers in many jurisdictions, they remain a critical component to an IPO that merits review and analysis by parties to any such transaction. Equity research reports are prepared by financial institutions to provide an analysis to be used by investors in a particular issuer's securities In the U.S., the Financial Industry Regulatory Authority (**FINRA**), a self-regulatory entity for the financial services industry, has a number of rules addressing potential conflicts in the content and distribution of such reports. These rules address a key concern that research reports prepared by a financial institution could be subject to conflict of interest where the institution is also involved in the marketing of the securities as underwriters. In this circumstance, the financial institution may be tempted to prepare research that is favorable to the issuer and the transaction in question rather than providing a more independent assessment of the merits of the offering. The FINRA rules focus on requiring information barriers and similar safeguards within a financial institution between deal team members (those bankers working on an IPO) and the research analysts who prepare research guidance to be used by potential investors, as well providing restrictions with respect to the timing of publication of any such report during "quiet periods" relating to the offering in question.

While larger financial institutions have robust internal policies and mechanisms to address the preparation and publication of equity research reports, these institutions rely on their external U.S. counsel working on the transaction to prepare research report guidelines and provide specific guidance relevant to a particular transaction. This guidance includes the preparation of detailed equity research guidelines containing a detailed discussion of restrictions on content (such as: avoiding projections and limiting coverage to information otherwise provided to investors through the transaction disclosure), timing of publication and interactions between analysts and members of a transaction deal team. In addition to preparing guidelines for use by the underwriters, international counsel to the underwriters is relied upon to review the draft equity research reports ahead of their publication to ensure compliance with the relevant guidelines.

In addition to the FINRA rules in the U.S., there are specific rules imposed in Brazil by the CVM regarding the content of any equity research report and restrictions on their distribution in connection with transactions registered with the CVM. Most likely, an international counsel prepares guidelines with respect to U.S. law considerations and market practice, while a Brazilian counsel to the underwriters provides them with written guidelines with respect to compliance with CVM rules. As such, international and Brazilian counsels must work closely to provide clear guidance to the underwriters with respect to all elements of the research report process.

Selling Shareholders

Where an IPO involves a "secondary" offering (sales of already issued shares by one or more selling shareholders), there may be sensitivity on the part of the prospective issuer and the relevant selling shareholders as to how selling shareholders should be treated with respect making certain representations and for purposes of the underwriters' indemnification, particularly when the selling shareholders are entities that are controlled by Brazilian federal, state or municipal governments.

Therefore, a point of sensitivity when dealing with a governmental selling shareholder or one controlled by a Brazilian governmental entity is to what extent such selling shareholder can be deemed as an "insider" of the issuer for purposes of making certain representations and warranties as well as providing indemnification to underwriters in the context of the proposed IPO transactions. As a matter of risk allocation, underwriters typically require that selling shareholders provide the same level of indemnification and make representations in line with the corporate issue of the securities in question. However, governmental shareholders may not have the same level of involvement in the day-to-day operations of a corporate issuer and may thus be reluctant to provide the same level of representation coverage and indemnification as would other parties selling shares in an IPO.

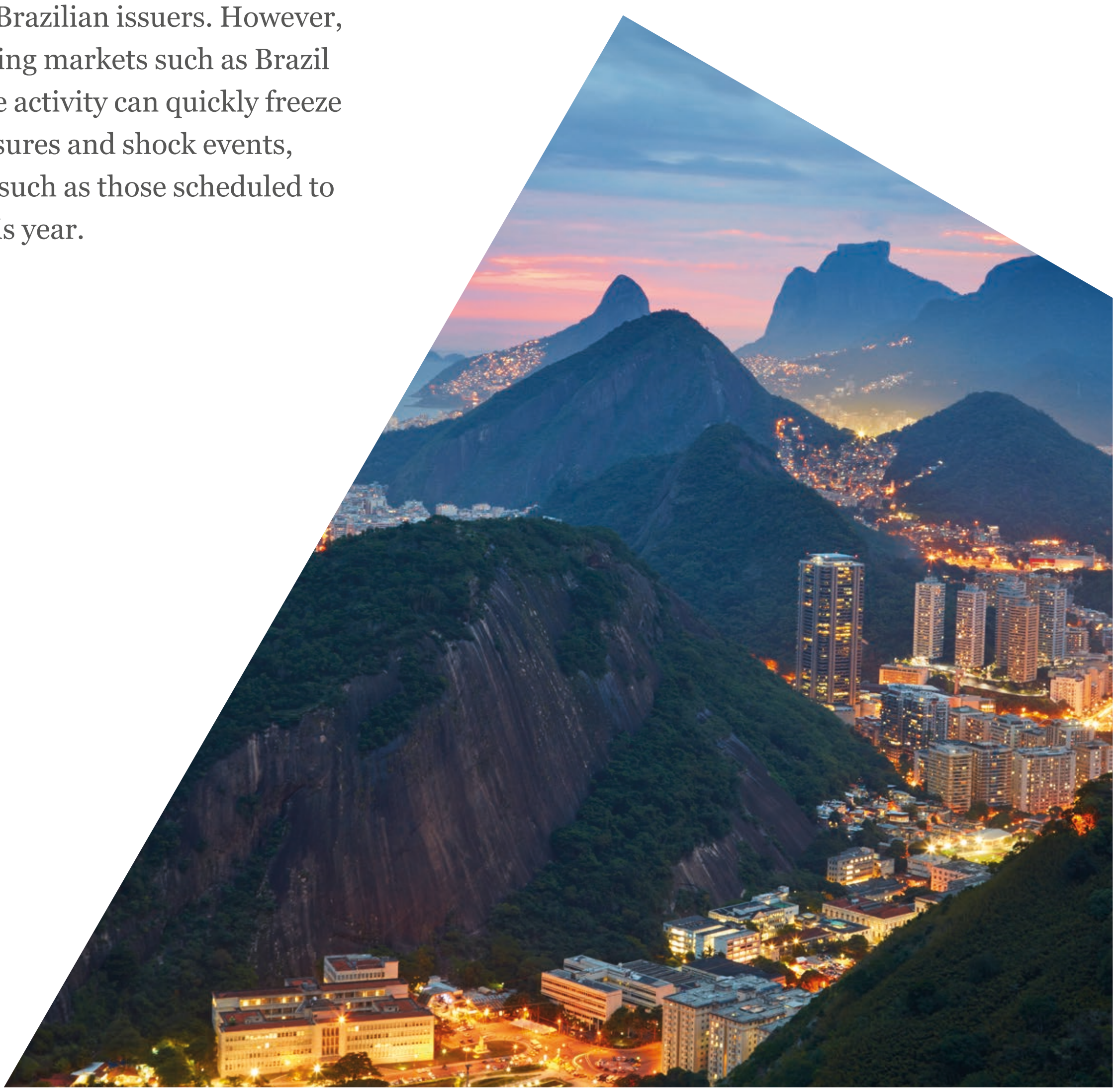
Conclusion

Indications are that the Brazilian economy has begun to expand and increasing amounts of capital will be needed to finance such growth. Following several years of modest issuance activity, Brazilian issuers may be increasingly more likely to access the equity capital markets to finance their operations. Despite market challenges arising from the on-going political scandals in Brazil, the recent IPO activity demonstrates that international investors have an increased appetite for equity securities issued by Brazilian issuers. However, economic activity in emerging markets such as Brazil can be volatile and issuance activity can quickly freeze as a result of systemic pressures and shock events, including federal elections such as those scheduled to take place in Brazil later this year.

Contacts

David Contreiras Tyler
Counsel, New York
T +1 212 918 3619
david.tyler@hoganlovells.com

Renato Villaca Di Dio
International Visiting Attorney, New York
T +1 212 918 6394
renato.villacadidio@hoganlovells.com



Bolsa Institucional de Valores:

A new financing option for Mexican SMEs

The Mexican securities market is finally adding competitiveness and innovation to its sector. After operating for almost half a century with one single player, the only stock exchange in Mexico is about to confront a new competitor that will try to attract a broader range of participants to the market.

Mexico's capital market outlook

The range and depth of securities markets vary significantly from country to country. According to a 2017 report from the World Federation of Exchanges, Mexico has the world's 15th largest economy, while only having the 23rd largest with regards to market capitalization. Most of the countries that precede Mexico's place in the GDP scale have multiple exchanges: United States with 11, Canada with five, England and Spain with four, and France and Italy with two; Brazil is currently in the process of authorizing a second exchange.

In the much more comparable Latin American market of emerging economies, Mexico is still behind in terms of stock market capitalization. According to World Bank data, during 2016 the stock market in countries such as Chile, whose economy is a fourth in size compared to Mexico, represented about 86% of its GDP at the end of last year, while the Mexican market only represented 34%. Additionally, Brazil's securities market constituted 42% of the country's GDP with more than 400 shares listed on its currently existing exchange.

In recent years, the national capital market has contributed on average only between 30 to 40% of the country's total GDP. During this time, new products have been introduced, such as the development capital certificate (*Certificado de Capital de Desarrollo*, or **CKD**), and increased transparency measures and better quality of governance and institutions have contributed to improve the market's financial performance.

Following examples of other economies around the world that have evolved towards competitiveness between exchanges creating better offers of products for intermediaries, investors and issuers, Mexico is betting on a new stock exchange. This new platform will offer an alternative for financing, thus encouraging investment in companies that will consequently make the industry and the economy grow.

BIVA's origins

Bolsa Institucional de Valores (**BIVA**) first originated as a project from Central de Corretajes, S.A.P.I. de C.V. (**CENCOR**), a corporate group focused on the development of infrastructure for the financial markets in Mexico.

In early 2013, CENCOR submitted the project to the Mexican financial authorities in an effort to create a new securities exchange. Since then, it has worked closely with the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público* (**SHCP**)), the Bank of Mexico (*Banco de México* (**BANXICO**)), and the National Baking and Securities Commission (*Comisión Nacional Bancaria y de Valores* (**CNBV**)) towards its development.

On 29 October 2015, CENCOR formally requested a concession to form and operate BIVA, which was granted on August 29 2017. On this date, President Enrique Peña Nieto signed the concession with an indefinite operational validity period, making BIVA the first securities exchange in four decades to compete against the Mexican Securities Exchange (*Bolsa Mexicana de Valores* (**BMV**)).

Fostering competitiveness

What is BIVA's business strategy?

BIVA expects to compete for 30% of the total income of Grupo Bolsa Mexicana de Valores, which operates BMV. To this effect it will seek to attract new players by offering them an alternative to raise capital through listing on this exchange, targeting SMEs and a part of the companies whose shares are currently listed on the BMV. BIVA will be able to operate with all the securities that are listed on the BMV today; new issuers will be able to choose to be listed in either or both, whilst having to choose where to have their main listing.

- **Use of new technologies:** The new securities exchange is focusing on a modern and tech-savvy set up. It will have the technological backing of Nasdaq through its exchange system known as Nasdaq X-Stream Trading, used by more than 70 markets worldwide. BIVA will also be using the trade surveillance platform known as Nasdaq-SMARTS, in order to ensure the transparency and integrity of the market. Both X-Stream Trading and NASDAQ-SMARTS are digital platforms specialized in surveillance automation, trading of goods, risk controls and data management.
- **Close attention and proximity with the issuers:** Executives from BIVA have mentioned that they will offer discounted listing rates compared with those charged today, though stressing that competition does not occur exclusively in listing prices since they only represent 10% of the total expenses associated with placements. The exchange has further asserted that its actual competitive strong point will be its client support by accompanying the companies before, during, and after the placement, in addition to creating customized reports for each issuer.
- **Reaching SMEs:** In Mexico there are around 17,000 midsized companies, 60% of which do not have any source of financing, according to the National Institute of Statistics and Geography (*Instituto Nacional de Estadística y Geografía*). BIVA's goal is to initially reach at least 50 new companies, particularly by looking for and attracting midsized companies and appealing to this niche market, without ruling out the possibility of including larger firms. To achieve this objective, BIVA will place a cap on the value of capitalization below what the BMV requires, placing it between US$500m – US$800m. Spokespersons from BIVA have also highlighted the possibility of reaching 200 listed issuers in a period of three to five years. This will be analyzed alongside brokerage firms, which are the ones that have direct contact with the companies.

What are some benefits of having a second securities exchange?

The incursion of BIVA in the securities market is expected to provide the following benefits:

- reduction of transaction costs;
- greater liquidity;
- technological innovation;
- continuity in the operation of the market;
- execution alternatives;
- new and inclusive market indexes.

In addition to issuers who will have another option for their placements, other beneficiaries of this new exchange would include the large brokerage firms affiliated with the most important financial groups in Mexico, such as Banco Inbursa, Inversora Bursátil and Acciones y Valores Banamex. In the same way, small independent brokerage firms that focus on select markets, such as Value and CICasa de Bolsa, should also reap some of the benefits emerging from this development. Such entities would benefit from a greater supply of products, trading volumes and assets under management, as well as lower operating costs.

What are some risks that BIVA faces?

BMV has recently expressed its concerns on the possible risks involving the addition of a new securities exchange. Some industry leaders believe that Mexico's capacity to expand the scope of its capital market is limited. The current and—for the moment—only financial actor in this sector has commented through its CEO, José-Oriol Bosch, that the inclusion of a new exchange in such a small market could dry out the limited liquidity it possesses. Other spokespersons from BMV have also asserted that the arrival of BIVA would only fragment the market, and increases costs for issuers listing in two exchanges instead of just one. Experts have also sustained that BIVA will eventually end up charging virtually the same fees as BMV, and the service and attention provided by BIVA be the added value.

Next Steps for BIVA

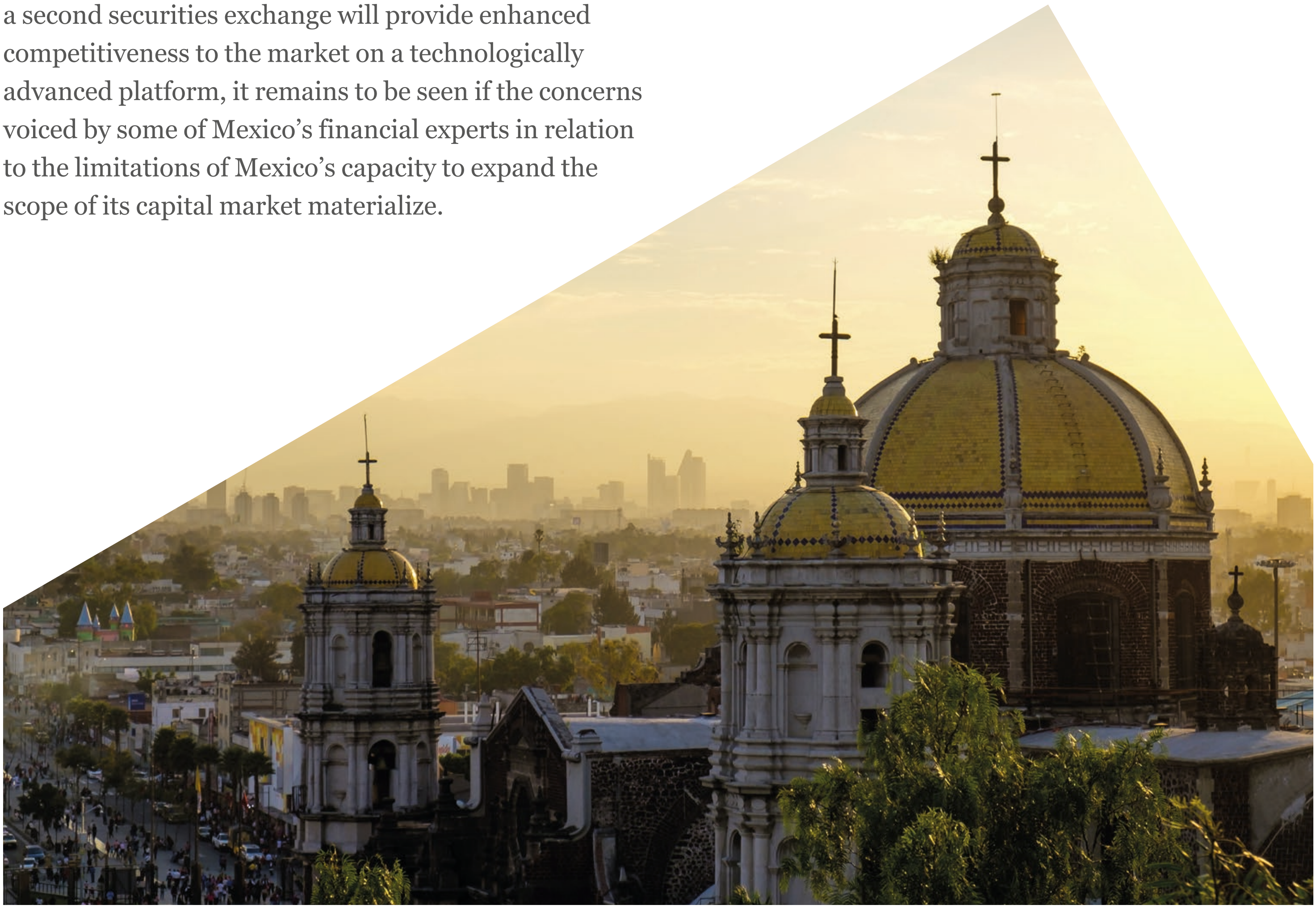
Preparations for BIVA's launch at the beginning of this year have been underway since the concession was granted in late August 2017; at the moment, technical and operational adjustments are being implemented, working alongside brokerage firms and the Mexican Association of Securities Exchange Intermediaries (*Asociación Mexicana de Intermediarios Bursátiles*). Financial authorities have been performing trial procedures of BIVA's operations since December 2017, and BIVA is expected to be fully operational and commencing its activities by March 2018.

Under the premise that an efficient financial market allows for a more efficient allocation of resources, BIVA aspires to be a viable option for SMEs with the capacity to grow, but that have not found an adequate source of financing. While there is little doubt that BIVA as a second securities exchange will provide enhanced competitiveness to the market on a technologically advanced platform, it remains to be seen if the concerns voiced by some of Mexico's financial experts in relation to the limitations of Mexico's capacity to expand the scope of its capital market materialize.

Contacts

René Arce Lozano
Partner, Monterrey
T +52 81 8220 1500
rene.arce@hoganlovells.com

Mayuca Salazar
Counsel, Mexico
T +52 81 8220 1515
mayuca.salazar@hoganlovells.com



MAS Green Bond Grant Scheme

Often referred to as "a city within a garden", Singapore has a proud tradition of forging ahead with "green" policies[1]. Launched by the Monetary Authority of Singapore (**MAS**) in June 2017, the Green Bond Grant Scheme (**the Scheme**) continues this tradition, aiming to nurture the growth of the green bond market and place Singapore at the forefront of this growing asset class.

Recognizing that bond issuers will incur additional costs in the issuance of green bonds – over and above the costs customarily incurred in the issuance of conventional bonds – the purpose of the Scheme is to assist issuers that are eligible for a grant under the Scheme (**Qualifying Issuers**) with the costs incurred in obtaining an external review of the bonds being issued (**Eligible Expenses**). Such review is necessary in order to ascertain whether the bonds, as assessed against internationally recognized criteria, truly are green in nature.

In order to take advantage of the Scheme, proceeds of bonds issued by Qualifying Issuers must be used to fund projects that deliver environmental benefits. In addition, the bonds must also meet certain key criteria (**Qualifying Criteria**) as prescribed by the MAS.

What is a Qualifying Issuer?

The criteria to be met in order to be designated a Qualifying Issuer for the purposes of the Scheme are not unduly onerous and reflect the MAS's intention to attract a wide range of international and domestic issuers to the Singapore market. An issuer satisfies the Qualifying Issuer test if it is a corporate entity or financial institution issuing green bonds, the only restriction being that sovereign issuers will not qualify. Applications may be made on behalf of first time or repeat issuers and may also be made multiple times on behalf of the same issuer, provided that each application relates to a different green bond issuance.

What are the Qualifying Criteria?

Aside from the requirement that the bonds issued are properly categorized as green bonds for the purposes of the Scheme, in order for a Qualifying Issuer to benefit from the Scheme, a number of other key criteria must be met, including the following:

- the bonds must be issued in Singapore and listed on the Singaporean stock exchange (the **SGX**); the issuer itself need not be a Singapore company;
- the principal amount of the issue must be at least S$200m (or the equivalent in any other currency);
- the tenor of the bonds must be at least three years and, with limited exceptions, the bonds must be non-redeemable during such three year period;
- the bonds must be a qualifying debt security under Singapore's Income Tax (Qualifying Debt Securities) Regulations (**ITR**);
- the lead manager must be a Financial Sector Incentive (**FSI**) company in Singapore[2];
- more than half of the gross revenue earned for work undertaken in arranging the issuance of the bonds, must be attributable to a FSI[3]; and
- an independent external review or rating, based on internationally recognized green bond standards, must be performed.

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1 http://www.mas.gov.sg/News-and-Publications/Speeches-and-Monetary-Policy-Statements/Speeches/2017/Speech-by-Mr-Lawrence-Wong-at-the-G20-Green-Finance-Conference.aspx

2 ITR Clause 4 (Arrangements for qualifying debt securities)

3 An overview of the Financial Sector Incentive Scheme may be found at http://www.mas.gov.sg/Singapore-Financial-Centre/Value-Propositions/Financial-Sector-Incentive-Scheme.aspx

What are Eligible Expenses?

In order for an issuance of bonds to be classified as green, a Qualifying Issuer will be required to appoint an external reviewer to provide an independent assessment, based upon internationally recognized green bond standards, such as the International Capital Market Association's Green Bond Principles (**GBP**)[4], the Climate Bond Standard[5], published by the Climate Bonds Initiative, or the ASEAN Green Bond Standards[6], published by the ASEAN Capital Markets Forum and based upon the GBP.

The external reviewer will provide an independent assessment of the bond's green credentials and in doing so will look at the following criteria:

– use of the proceeds of the bond issuance;

– the processes to be used by the issuer to evaluate and select green projects;

– the issuer's processes for managing and tracking the use of the bond proceeds;

– the framework established by the issuer for reporting details of the projects (funded by the bond proceeds) to investors.

Under the Scheme, 100% of any costs incurred by an issuer in relation to the external reviewer's provision of an independent assessment will be reimbursable, subject to a cap of S$100,000. Although only one application, per issuance, may be made for a grant under the Scheme, multiple applications on behalf of the same issuer are permitted, provided each application relates to a different issuance.

4 https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GreenBondsBrochure-JUNE2017.pdf

5 https://www.climatebonds.net/files/files/Climate%20Bonds%20Standard%20v2_0%20-%202Dec2015%20(1).pdf

6 http://www.theacmf.org/ACMF/upload/ASEAN_Green_Bond_Standards.pdf

What is the process for applying?

Although an application for a grant under the Scheme may only be made after the bonds have been issued, issuers that intend to issue green bonds and make an application under the Scheme should be aware that the following criteria will need to have been met at the time an application for a grant is made. Issuers are therefore encouraged to seek the advice of their external advisers at the pre-issuance stage of any proposed green bond issuance.

A lead manager, which must be an FSI company in Singapore, must be appointed by the issuer to perform due diligence on the proposed bond issue, in order to ascertain the eligibility of the bond for the Scheme.

Post-issuance, the lead manager, assisted by its external advisers, is the party that will submit a completed application form (along with relevant invoices for the reimbursement of Eligible Expenses) to the MAS, on behalf of the issuer. The application must be submitted within three months of the issue date of the bonds in order to be considered.

Summary

The implementation of the Scheme highlights the strategic focus of the MAS to promote sustainable financing in Singapore's financial sector and attract both international and domestic issuers to issue their bonds in Singapore and list them on the SGX. Although it is too early to determine what impact the Scheme will have in increasing Singapore's share of the global green bond market, with investor interest in this asset class continuing to grow, the introduction of the Scheme looks set to increase Singapore's competitiveness in the sustainable investment arena.

The Scheme is set to run for three years, from 1 June 2017 to 31 May 2020.

Contacts

Andy Ferris
Partner, Singapore
T +65 6302 2439
andy.ferris@hoganlovells.com

Ryan Spence
Senior Associate, Singapore
T +65 6302 2566
ryan.spence@hoganlovells.com

About us

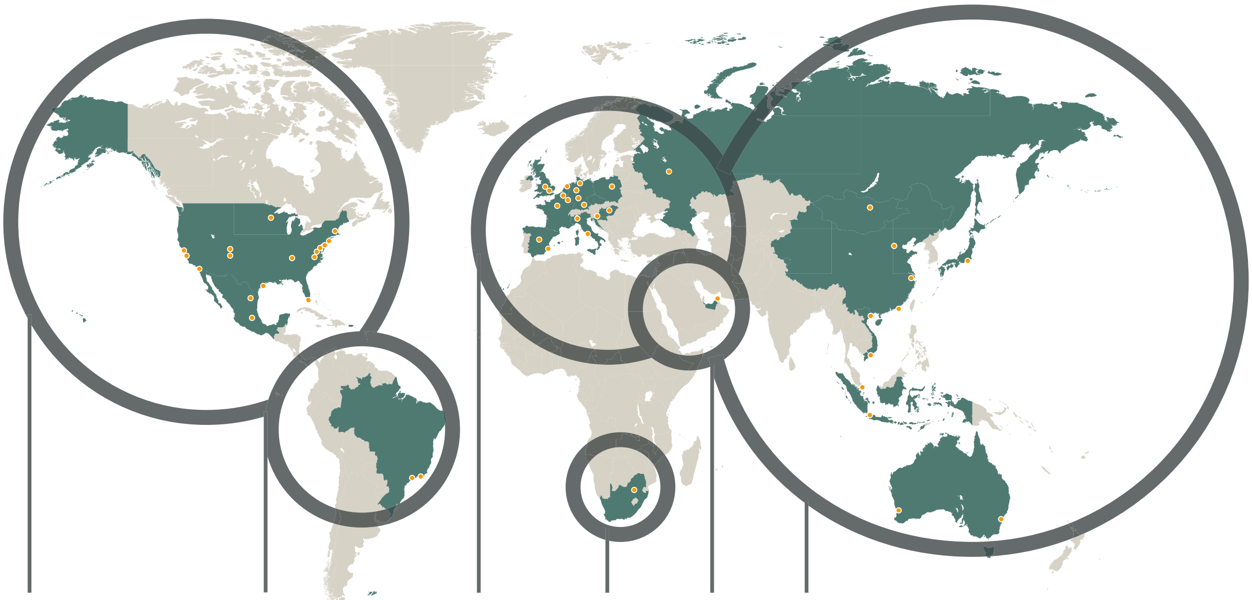
Change is happening faster than ever, and to stay ahead, you need to anticipate what's next. Legal challenges come from all directions. We understand and work together with you to solve the toughest legal issues in major industries and commercial centers around the world. Whether you're expanding into new markets, considering capital from new sources, or dealing with increasingly complex regulation or disputes, we can help. Whether change brings opportunity, risk, or disruption, be ready by working with Hogan Lovells.

Straight talking. Understanding and solving the problem before it becomes one. Delivering clear and practical advice that gets your job done. Hogan Lovells offers extensive experience and insights gained from working in some of the world's most complex legal environments and markets for corporations, financial institutions, and governments. We help you identify and mitigate risk and make the most of opportunities. Our 2,500 lawyers on six continents provide practical legal solutions wherever your work takes you.

A fast-changing and inter-connected world requires fresh thinking combined with proven experience. That's what we provide. Progress starts with ideas. And while imagination helps at every level, our legal solutions are aligned with your business strategy. Our experience in cross-border and emerging economies gives us the market perspective to be your global partner. We believe that when knowledge travels, opportunities arise.

Our team has a wide range of backgrounds. Diversity of backgrounds and experience delivers a broader perspective. Perspectives which ultimately make for more rounded thinking and better answers for you.

Giving back to communities and society is fundamental to good business. And, it's part of our core. We are advocates of justice, equality, and opportunity. Everyone at Hogan Lovells is asked to volunteer at least 25 hours a year as part of their normal work duties. Around the world, our people are making a difference through pro bono activities, community investment, and social justice.



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Our International Debt Capital Markets practice

Debt Capital Markets - General

Are you looking for capital to grow your business, expand into new markets, or strengthen your balance sheet? We advise clients on all aspects of international debt capital markets transactions including corporate, financial institution and sovereign bonds. Our clients include arrangers/underwriters, corporate, financial institution and sovereign issuers, and transaction services providers.

We have a global practice with lawyers in the major jurisdictions of Europe, the United States, Latin America and Asia. Our size, experience and specialization enable us to offer expert and competitive advice on a full range of capital markets transactions. We also have considerable experience in emerging markets economies.

Our strong restructuring practice means that we are well positioned to react to distressed market conditions and we are a leading provider of legal services to trustees and other relevant market participants.

We are consistently ranked in the world's leading legal directories for our international debt capital markets practice and we are one of the leading players in the numerous capital markets disciplines.

Areas of focus

– corporate debt and equity-linked securities offerings
– sovereign debt
– establishment of, updates to and drawdowns under debt issuance programmes
– tender offers, exchange offers and other liability management transactions
– promissory notes (schuldscheine)
– debt restructurings
– subordinated debt as part of prudential capital for financial institutions
– credit-linked and loan participation note offerings
– islamic finance transactions.

Structured Finance and Securitization

Hogan Lovells Structured Finance and Securitization practice handles every aspect of structured finance transactions. Our global team has handled deals with assets originating in more than 30 countries. We help issuers and originators of securitized assets, underwriters, managers and arrangers, trustees, investors, and collateral and portfolio managers.

We advise on the financing of a wide range of classic and innovative asset types, both as public and private stand-alone issues, master trusts, programs, and through conduit structures. In addition, we run one of the few practices able to offer dedicated and knowledgeable advice to capital markets trustees.

Our team is involved in issues regarding the changing regulatory environment relating to structured finance, Dodd-Frank legislation in the US and the relevant EU directives and regulations, including, compliance counselling, disclosure and advocacy relating to the legislation. We also advise clients on issues relating to derivatives related infrastructure, including clearing, data repositories, broker-dealer matter and exchange execution.

Areas of focus

– ABCP
– auto and consumer loan and lease
– CLOs
– commercial mortgage backed (CMBS)
– covered bonds
– equipment leases and operating assets
– future flow securitizations from emerging markets
– infrastructure
– insurance
– market place lending
– residential mortgage backed (RMBS)
– trade receivables
– whole business.

Derivatives and Structured Products

Hogan Lovells advises clients across the world on a complete range of derivative and structured product transactions across all asset classes.

Our practice is truly global. With dedicated derivatives and structured products lawyers in Europe, the United States and Asia and capital markets lawyers across our global network of offices, we have one of the most integrated teams in the market.

We understand the considerable and complex legal, regulatory and tax implications of these products, including the cross-border implications of their use. Working closely with lawyers in our renowned finance, disputes, tax, regulatory and insolvency departments, we provide our clients with practical, timely advice on all aspects of their business. We have significant experience in advising clients on various regulatory matters applicable to derivatives across the world: from the United States under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the European Union under the European Market Infrastructure Regulation ("EMIR") to the local regulations in various jurisdictions across Asia. In addition, our team is particularly strong in structured finance and structured finance-related derivatives, having established and updated many securitization and repackaging programs that contain swaps and repos.

Our clients include major financial institutions, funds, government sponsored entities, asset managers and commercial end-users. Our size, global reach, experience and specialization enable us to provide clients with a competitive, knowledge-based service for all derivatives and structured products transactions.

Areas of focus

- energy and commodities
- regulatory matters
- securitized derivatives and repackaging programmes
- soft commodities and metals
- equity derivatives
- credit derivatives
- fund derivatives
- portfolio acquisitions and disposals
- structured finance, securitization-related, fixed income and other treasury related matters
- longevity and insurance linked derivatives
- distressed derivatives.

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