Hogan Lovells

Debt Capital Markets – Global Insights

Spring 2020

Welcome

We are delighted to present the Spring 2020 edition of Hogan Lovells' Debt Capital Markets Global Insights. This draws together a collection of articles from across our global network, reflecting on current events and topical themes of relevance to participants in international debt capital markets.

Whilst some themes are specific to a particular jurisdiction, region or product, many relate to broader trends that we are seeing across the global debt capital markets. A good example of this is the on-going push by regulators in relation to benchmark reform and specifically how the market is going to address the rapidly approaching discontinuation of LIBOR. These are not easy issues, both in terms of developing new market standards and also addressing legacy positions. Another theme that is very much at the top of the market's agenda is the impact of environmental, social and governance (ESG) criteria on products and the growing demand from investors and participants for this to be an integral part of product development.

We hope you find this selection informative and interesting and our team would be happy to discuss any of the subjects raised in more detail with you.

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"The Net Short": U.S. and European High-Yield Covenant Trends in Response to Net Short Activism

Background

On February 15, 2019, the U.S. District Court for the Southern District of New York issued its ruling in the case of Aurelius Capital Master, Ltd. (**Aurelius**) against Windstream Services, LLC (**Windstream**). The origins of the case date back to April 2015, when one of Windstream's affiliates spun off and, subsequently, leased back some of its real estate and other assets. Two years after that transaction, Aurelius, a fund that purchased a controlling position in Windstream's 6.375% Senior Notes due 2023 (the **2023 Notes**), challenged the transaction, alleging that the sale and leaseback was not permitted under the 2023 Notes indenture, and issued a notice of acceleration related to the 2023 Notes. The district court ruled in favor of Aurelius, stating that the transaction resulted in an event of default under the 2023 Notes indenture and that Aurelius' notice of acceleration was valid. This meant that Windstream was consequently in default under a number of its other debt instruments, by virtue of cross-default or cross-acceleration provisions in those instruments, and faced an immediate liquidity crisis with no access to financing to fund its business operations. As a result, on February 25, 2019, Windstream filed for Chapter 11 bankruptcy, despite the fact that at the time it had no operational failures.

It has been generally understood that, at the time it brought its suit against Windstream, Aurelius held credit default swaps (**CDS**), creating a net short position in Windstream's debt. For a typical noteholder with a net long position in a note[1], especially one that is structurally-, lien- or payment-subordinated in the capital structure, the issuer's bankruptcy would generally be viewed as undesirable because of the risk that potential recoveries under the note could be significantly lower than par (or the amount the holder paid to purchase the notes). In contrast, noteholders with a net short position in a note would arguably operate under an opposite set of economic incentives because the CDS would pay out if the reference entity (such as Windstream, in the case of CDS protection on the 2023 Notes) experiences an adverse credit event (such as, among others, a payment default or bankruptcy filing, as in the Windstream case). As such, a net short noteholder may not be interested in negotiating with an issuer and its group to find ways to avoid bankruptcy if any issues arise during the term of the notes.

The use of CDS-driven investment strategies by certain credit investors that benefit from an issuer's credit event has the potential to upend the historically aligned incentives of all noteholders in a particular class of an issuer's debt. Windstream was only the latest in a number of CDS-driven debt defaults by corporate issuers, from the Spanish gaming company Codere in 2013 to the homebuilder Hovnanian in 2017 (which also resulted in litigation that was finally settled in 2018).[2] Consequently, there has been a growing awareness among participants across the loan, high-yield and derivatives markets of the need to effectively address the potential impact of CDS, or similar instruments, on both issuer-creditor and intercreditor relationships and on the credit markets, generally.

On September 19, 2019, the Chairmen of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission, along with the Chief Executive of the U.K. Financial Conduct Authority, issued an Update to June 2019 Joint Statement on Opportunistic Strategies in the Credit Derivatives Market, where the agencies outlined concerns about continued pursuit of various opportunistic strategies in the credit derivatives markets, including "manufactured credit events", and their potential adverse impact on the "integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally".[3] The agencies emphasized that they "expect firms to consider how the aforementioned opportunistic strategies may impact their businesses and to take appropriate action to mitigate market, reputation and other risks arising from these types of strategies". The agencies "look forward to further

1 A noteholder's hedging strategy with respect to a specific bond or an issuer may employ short positions in CDS or another type of security, and this type of hedging activity has generally been viewed as standard by the market.

2 Note that, unlike Windstream, Codere and Hovnanian involved a "manufactured default", whereby net short activists cooperate with, and encourage the issuer, which is an otherwise solvent company, to deliberately default on its debt, thereby triggering a credit event and pay-out under CDS purchased against the reference security.

3 *See* Update to June 2019 Joint Statement on Opportunistic Strategies in the Credit Derivatives Market, *available at* https://www.sec.gov/news/public-statement/update-june-2019-joint-statement-opportunistic-strategies-credit-derivatives (Sept. 19, 2019). *See also* Joint Statement on Opportunistic Strategies in the Credit Derivatives Market, *available at* https://www.sec.gov/news/press-release/2019-106 (June 24, 2019).

industry efforts to improve the functioning of the credit derivative markets and welcome continuing engagement with market participants".[4]

While potential legislative responses to the issue remain possible, loan and high-yield bond market participants have presently endeavored to address the issue by introducing two main types of contractual restrictions in debt documentation:[5]

(1) a **net short disenfranchisement (NSD) provision**, which prohibits a noteholder from exercising its voting rights if it effectively holds a "net short" position in a specific instrument; and

(2) a **sunset on covenant enforcement provision**, which prohibits default notices following a certain period (typically, two years) after the triggering action or event was originally reported to noteholders or publicly.

In this note, we examine the key terms and mechanics of these provisions and provide an overview of the trends and changes in their formulations over 2019 in the U.S. and European high-yield bond markets. These formulations continue to develop and have not yet been widely tested on the U.S. or European markets.

Net Short Disenfranchisement

In 2019, the NSD provision was included in the final terms of a small, but growing number of U.S. high-yield offerings, generally those involving private equity sponsor-owned companies. This provision was also introduced in the preliminary terms of a couple of European high-yield offerings during 2019, although it was retained in the final terms of only one of the offerings (i.e., following the completion of the marketing process and discussion of the proposed terms between the issuer and investors).[6]

The NSD provision may include several important variations, which drafters should be aware of to ensure that the provision, if incorporated in high-yield bond deals, strikes the right balance between protection of the issuer and net long noteholders against net short activism without overreaching in its scope such that the overall liquidity in the notes is negatively affected.

4 We briefly note that there have already been certain changes in the derivatives markets aiming to address some issues with the so-called "narrowly tailored credit events" or "manufactured defaults". Specifically, on July 15, 2019, the International Swaps and Derivatives Association ("**ISDA**") published the 2019 Narrowly Tailored Credit Event Supplement (the "**NTCE Supplement**") to the 2014 ISDA Credit Derivatives Definitions.
The NTCE Supplement amends two key definitions relating to the "narrowly tailored credit events", which are events that are significant enough to trigger credit events under a CDS contract leading to its settlement, but narrow enough to avoid actually impairing the creditworthiness or financial condition of the company on which the credit event is determined (the "**Reference Entity**"). In particular, the NTCE Supplement amends the definition of a "Failure to Pay" by introducing a "Credit Deterioration Requirement". If this requirement is specified as applicable in the relevant CDS contract then a failure to make due payment "shall not constitute a Failure to Pay if such failure **does not directly or indirectly either result from, or result in, a deterioration in the creditworthiness or financial condition of the Reference Entity**". *See* 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions, *available at* https://www.isda.org/book/2019-narrowly-tailored-credit-event-supplement-to-the-2014-isda-credit-derivatives-definitions.
CDS parties can effectively apply the NTCE Supplement to their existing contracts by adhering to the ISDA 2019 NTCE Protocol, which was published on September 16, 2019. *See* ISDA 2019 NTCE Protocol, *available at* https://www.isda.org/protocol/isda-2019-ntce-protocol.
The NTCE Supplement will apply to uncleared CDS (except where the transaction references a sovereign Reference Entity) that are entered into on or after the implementation date (set for Jan. 27, 2020). Cleared trades are not covered by the NTCE Supplement and are instead addressed by equivalent amendments to the central clearinghouse's rulebook.

5 While comparable structures have also been introduced in the U.S. and European loan markets, this publication primarily focuses on the trends seen in the U.S. and European high-yield markets.

6 We have already seen the NSD provision appearing in the preliminary terms of at least one European high-yield offering in January 2020.

(1) Scope of Application

Drafters must carefully consider the scope of activities and voting rights affected by the NSD provision. So far, there have generally been two main approaches to this so-called "net short" position representation (**Position Representation**):

(1) a provision stating that **any notice of default, notice of acceleration or instruction to the Trustee to provide a notice of default, notice of acceleration or to take any other action** provided by any one or more holders must be accompanied by a written representation that the applicable beneficial owners of the notes are not "net short" (**Default Notice Position Representation**); and

(2) a broader provision stating that **each amendment, supplement, waiver or modification of the indenture or the notes, as well as any other request, demand, authorization, direction, notice, consent or waiver under the indenture** must be accompanied by a written representation that the applicable beneficial owners of the notes are not "net short" (**General Amendment Position Representation**).

In the high-yield offerings containing the NSD provisions in 2019, the Default Notice Position Representation was more prevalent, and it arguably more directly addresses the Windstream scenario, where the underlying issue was an alleged uncured covenant default. However, there is some concern that net short activists could block the adoption of proposed amendments, waivers or other modifications of the indenture that are intended to "defuse" or forestall potential covenant breaches or other events that could potentially result in an event of default under the governing indenture and are, therefore, viewed as beneficial from the perspective of the issuer and net long noteholders, by refusing to vote in favor of such amendments, waivers or other modifications. Accordingly, certain issuers have sought to include the more comprehensive General Amendment Position Representation in their high-yield bonds.

(2) Net Short Definition and Treatment of Affiliates

In the NSD provisions with the Default Notice Position Representation, "Net Short" is generally defined along the lines of the following example:

***Net Short** means, with respect to a Holder or beneficial owner, **as of a date of determination**, either (i) the **value** of its **Short Derivative Instruments** exceeds the sum of (x) the **value** of its Notes plus (y) the **value** of its **Long Derivative Instruments as of such date of determination** or (ii) it is reasonably expected that such would have been the case were a **Failure to Pay**[7] or **Bankruptcy Credit Event** (each as defined in the 2014 ISDA Credit Derivatives Definitions) to have occurred with respect to the Issuer or any Guarantor immediately prior to such date of determination.*

Derivative Instrument is generally defined as follows:

***Derivative Instrument** with respect to a Person, means **any contract, instrument or other right to receive payment or delivery of cash or other assets to which such Person** or any Affiliate of such Person that is acting in concert with such Person in connection with such Person's investment in the Notes (other than a Screened Affiliate) **is a party** (whether or not requiring further performance by such Person), **the value and/or cash flows of which** (or any material portion thereof) are **materially affected** by the value and/or performance of the Notes and/or the creditworthiness of the Issuer and/or any one or more of the Guarantors (the "Performance References").*[8]

Instead of "value", some examples of the "Net Short" definition refer to the "notional amount" (particularly in the NSD provisions with the General Amendment Position Representation).[9] It is generally not explicitly stated in the "Net Short" definition whether the use of the term "value" means "fair value", "notional amount" or some other measure. However, consistent with market and accounting practice, "value" should be deemed to refer to "mark-to-market value" or "fair value" and not "notional amount".[10] Notably, the Default Notice Position Representation is typically deemed to be provided on a "continuing basis" (i.e., it is deemed a continuing representation until the date the event of default at issue is cured, waived or otherwise ceases to exist). The calculation of "value" for many derivative instruments, therefore, is difficult, as the derivative instrument's value could fluctuate during the life of the contract due to market movements and other factors, making it difficult to monitor the ongoing position. On the other hand, since "notional amount" is a "notional" figure, it may not accurately capture the economic value and power held by the noteholder and not account for fluctuations in such value.

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7 *See supra* note 4 for discussion of the recent amendments to the "Failure to Pay" definition.

8 "Short Derivative Instrument" is generally defined to mean a "Derivative Instrument (i) the value of which generally decreases, and/or the payment or delivery obligations under which generally increase, with positive changes to the Performance References and/or (ii) the value of which generally increases, and/or the payment or delivery obligations under which generally decrease, with negative changes to the Performance References". Conversely, "Long Derivative Instrument" is generally defined to mean a "Derivative Instrument (i) the value of which generally increases, and/or the payment or delivery obligations under which generally decrease, with positive changes to the Performance References and/or (ii) the value of which generally decreases, and/or the payment or delivery obligations under which generally increase, with negative changes to the Performance References".

9 See a general example below:
*"Net Short Holder" means **any Notes Beneficial Owner** (alone or together with its Affiliates (but subject to clause (vi) below)) (other than any Notes Beneficial Owner that is a Regulated Bank) **that**, as a result of its (or its Affiliates' (but subject to clause (vi) below)) interest, whether held directly or through any intermediary, in any total return swap, total rate of return swap, credit default swap or other derivative contract (other than any such total return swap, total rate of return swap, credit default swap or other derivative contract entered into pursuant to bona fide market making activities), **has a net short position with respect to the Notes**. For purposes of determining whether a Notes Beneficial Owner (alone or together with its Affiliates (but subject to clause (vi) below)) has a "net short position" on any date of determination: (i) **derivative contracts with respect to the Notes** and such contracts that are the functional equivalent thereof **shall be counted at the notional amount thereof** in Dollars; " . . . "*

10 Fair value is defined under the U.S. accounting standards (Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements,* paragraph 5) and the International Financial Reporting Standards (IFRS 13) as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date".

Furthermore, in assessing whether it has a "net short" position, a noteholder would typically also need to include its affiliates that are "acting in concert" with respect to a specified investment. For some noteholders, such as financial institutions, additional internal tracking systems may need to be put in place in order to include affiliates in the determination of whether they have a "net short" position. Although "screened affiliates"[11] are generally excluded for purposes of the calculation, the NSD provisions with the General Amendment Position Representation typically provide that "screened affiliates" can only be excluded after the noteholder's "reasonably inquiry" as to whether that affiliate has any interest in any notes and/or any applicable short instrument.

One important clarification on the "materially affected" prong of the "Derivative Instrument" definition, which we have seen in a minority of the proposed NSD provisions, is the exclusion of positions that a noteholder and its affiliates may have in any general index.[12]

(3) Verification Covenant

The majority of NSD provisions which cleared the market in 2019 (particularly those with the Default Notice Position Representation) also included a covenant that holders will provide (typically, within five business days) the issuers with such other information as the issuers may reasonably request from time to time in order to verify the accuracy of such noteholder's Position Representation.

(4) Consequences of Breach and Forced Transfer

While most formulations of the NSD provision state that the vote of any noteholders who misrepresented or violated their Position Representation should be disregarded, it is important to consider whether the respective notes held by such noteholders will be subtracted only from the numerator or from both the numerator and the denominator in determining the final outcome of the vote. This is an important distinction as the second approach prevents the potential dilutive effect of the breaching noteholders' vote. The NSD provisions with the General Amendment Position Representation typically include an explicit provision that the notes owned by any net short holders are to be deemed disregarded and not outstanding for the purposes of determining whether the requisite amount of outstanding notes voted in favor of any amendment, waiver or notice.

In addition, high-yield offerings containing the NSD provisions with the General Amendment Position Representation also include another issuer-friendly provision that allows the issuer to require any noteholder that makes an incorrect Position Representation or breaches its covenant not to take any prohibitive actions to transfer the notes in question back to the issuer at the lesser of (i) the principal amount of the notes and (ii) the most recently available quoted price for such notes (as determined by the issuer in good faith).

(5) Stay on Cure Period During Litigation

Another important caveat that has been present in a number of formulations of the NSD provisions (particularly those with the Default Notice Position Representation) is the stay on cure period, which provides that if, following the delivery of the Position Representation, the issuer: (i) determines, in good faith, that there is a reasonable basis to believe that a noteholder was, at any relevant time, in breach of the Position Representation and (ii) initiates litigation seeking to invalidate any event of default on this ground, then the running of the cure period with respect to the relevant default shall automatically be stayed pending the court's final and non-appealable determination on such matter.

11 "Screened Affiliate" is generally defined along the lines of the following example:
"Screened Affiliate" means any ***Affiliate of a Holder*** *(i) that* ***makes investment decisions independently*** *from such Holder and any other Affiliate of such Holder that is not a Screened Affiliate, (ii) that* ***has in place customary information screens*** *between it and such Holder and any other Affiliate of such Holder that is not a Screened Affiliate and such screens prohibit the sharing of information with respect to the Issuer or its Subsidiaries, (iii) whose* ***investment policies are not directed by such Holder*** *or any other Affiliate of such Holder that is acting in concert with such Holder in connection with its investment in the Notes, and (iv) whose* ***investment decisions are not influenced by the investment decisions of such Holder*** *or any other Affiliate of such Holder that is acting in concert with such Holders in connection with its investment in the Notes.*

12 This concept is usually reflected in the "Derivative Instrument" definition through the inclusion of the following language at the end of the definition:
Derivative Instruments in respect of an index *that includes the Issuer or one or more of the Restricted Subsidiaries or any instrument issued or guaranteed by the Issuer or one or more of the Restricted Subsidiaries* ***shall not be deemed to be "materially affected" with respect to the Notes and/or the creditworthiness of the Issuer and/or one or more of the Restricted Subsidiaries, so long as the Issuer and the Restricted Subsidiaries and any instrument issued or guaranteed by the Issuer and the Restricted Subsidiaries, collectively, shall represent less than 5% of the components of such index.***

Sunset on Covenant Enforcement

This provision was developed in parallel to the NSD provision as another potential response to net short activism. Typically, if an event of default takes place under the indenture at any point during the term of the notes, the trustee or the holders of a certain percentage of the outstanding notes can declare the notes to be due and immediately payable, subject to certain notification requirements and the running of a grace period. The newly introduced sunset provision, however, provides that: "a notice of Default may not be given with respect to any action taken, and reported publicly or to Holders, ***more than two years prior to such notice of Default***".

It is important to note that this provision could potentially be read as more limiting than the NSD provision as it covers the actions of all noteholders, regardless of their net short position. In 2019, the majority of high-yield offerings including the NSD provision also included the sunset on covenant enforcement provision. Moreover, there have been a few market examples where the sunset on covenant enforcement provision appeared without the NSD provision.

Final thoughts

While the NSD and the sunset on covenant enforcement provisions were featured only in a minority of U.S. high-yield offerings in 2019, we expect to see the drafting of both provisions to continue to evolve going forward and, potentially, see their broader adoption in future offerings as they gain further market acceptance. The European high-yield market has not, to date, actively adopted these provisions. However, as these provisions gain further traction in the U.S. high-yield market, certain types of offerings in Europe, particularly sponsor-led transactions, are likely to start pushing for inclusion of similar provisions. Furthermore, similar language is currently being introduced in some credit facilities in the U.S. (and, to a smaller extent, in Europe) and we, therefore, expect that, over time, there will be an expectation to mirror these provisions in high-yield documentation in order to align the terms of borrowers' high-yield indentures and credit facilities.

We will continue to monitor developments in this area and welcome any queries you may have.

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UK FCA gives guidance on conduct risk during LIBOR transition

Following Andrew Bailey's speech in July 2017 that the UK Financial Conduct Authority (**FCA**) would, from the end of 2021, no longer be persuading or compelling banks to submit quotes to LIBOR (the London Interbank Offered Rate) and that market participants should therefore not rely on LIBOR being available after that date, the FCA expects firms to be taking appropriate steps to ensure they can transition to alternative risk-free reference rates (**RFRs**) before this.

Recently, in response to a letter from the Working Group on Sterling Risk-Free Reference Rates (**£RFR Working Group**), the FCA published some Q&As on conduct risk during LIBOR transition which set out its core expectations of firms during the transition away from LIBOR.

The FCA's supervision of firms' transition away from LIBOR is focused on firms effectively managing the risks arising from such transition, including prudential, operational and conduct risks.

Governance and accountability

Unsurprisingly, the FCA reiterates its previous messages that firms' senior managers and boards are expected to understand the risks associated with LIBOR transition and take appropriate action to move to alternative rates ahead of end-2021.

While firms are under general regulatory obligations to have effective processes and controls to identify, manage, monitor and report risks to their business, firms need to consider whether any LIBOR-related risks are best addressed within their existing conduct risk frameworks or, instead, need a separate, dedicated program. In many firms, LIBOR transition will impact the overall business and front-office client engagement; therefore, the potential impact and risks need to be considered and addressed in an appropriately coordinated way across the firm.

Firms that are subject to the senior managers and certification regime (**SMCR**) should allocate responsibility for overseeing the transition away from LIBOR to an identified Senior Manager. In addition, those responsibilities must be detailed in the relevant Senior Manager's Statement of Responsibilities.

While the Prudential Regulatory Authority (**PRA**) and the FCA have previously called for a Senior Manager in banks and insurers to be allocated this responsibility in Dear CEO letters last year, as the SMCR is being rolled out to FCA solo-regulated firms in December, these requirements will apply to all firms affected by LIBOR transition.

Should a firm not manage its move from LIBOR effectively, the FCA has clearly signaled that it may look to hold not only the firm, but also the relevant Senior Manager accountable.

Senior Managers should, therefore, act with due skill, care and diligence, and, among other things, keep detailed records of management meetings or committees as evidence of the steps they took to so act. They should also make sure that the governance arrangements, frameworks and processes which are put in place to ensure a smooth transition are clearly documented and are embedded in the firm's transition program.

Should a firm not manage its move from LIBOR effectively, the FCA has clearly signaled that it may look to hold not only the firm, but also the relevant Senior Manager accountable.

Treating customers fairly when replacing LIBOR with alternative rates

The FCA is particularly concerned that firms take reasonable steps to treat customers fairly when replacing LIBOR with alternative rates in existing contracts and products, considering the contract as a whole to ensure that the replacement rate is fair.

Firms must, therefore, not replace LIBOR in existing contracts with a rate or terms that would be less favorable to the customer. For consumer contracts, firms are expected to consider the Consumer Rights Act 2015 and the FCA's finalised guidance on the Act.

When transitioning existing contracts, the FCA states that firms should ensure that, among other things, LIBOR transition is not used to move customers with existing contracts to replacement rates that are expected to be higher than LIBOR would have been or otherwise introduce inferior terms.

Inserting new fall back provisions – where new fall back provisions are incorporated into existing contracts to replace LIBOR with a new reference rate, firms must ensure that customers receive effective communication on how these fall back provisions are expected to operate (such as whether the clauses operate at, or before cessation, and on what basis).

Adopting a replacement rate – the FCA states that: "firms are more likely to demonstrate that they have fulfilled their duty to treat customers fairly where they adopt a replacement rate that aligns with the established market consensus, reached through appropriate consultation, and is recognised by relevant national working groups as an appropriate solution" and refers in particular to the work both of the International Swaps and Derivatives Association, Inc. (**ISDA**) and the £RFR Working Group.

Although the FCA acknowledges that industry initiatives are still ongoing, so firms will ultimately have to exercise their own judgement on when and how to remove LIBOR dependencies in legacy contracts by end-2021, it reiterates its previous calls to the market that the "most effective way to avoid LIBOR-related exposure is not to write new LIBOR-referencing business, and to transition to alternative rates, taking into account the considerations on selecting a fair replacement rate."

Offering new products with RFRs or alternative rates

If a firm continues to offer LIBOR-linked products that mature after 2021, it must carefully consider whether these products can meet the needs of customers and continue to perform in line with their expectations both before and after the discontinuation of LIBOR.

It is essential any such firm explains fully to its customers what will happen in the event of LIBOR ending and the impact on them. LIBOR-linked contracts that include robust fall back provisions help reduce, but do not always eliminate, these risks.

SONIA and other RFRs

SONIA compounded in arrears is the preferred RFR for sterling LIBOR – the FCA notes that in the derivatives and securities markets, SONIA compounded in arrears is established as the preferred alternative reference rate to sterling LIBOR and that the £RFR Working Group is of the view that SONIA, compounded in arrears, will and should become the industry standard in most parts of the bilateral and syndicated loan markets.

Forward-looking SONIA term rate – the FCA says that a forward-looking SONIA term rate compiled from transactions in SONIA derivatives markets could form the basis of a fair replacement rate for legacy cash products and it may also be an

The FCA offers comfort to firms indicating that it is possible to provide an objective overview of the benefits, costs and risks of a range of alternatives to a client's existing LIBOR-linked exposure, without offering a personal recommendation.

option for new products in some circumstances but may not be the optimal choice. There may be other products (such as products based on SONIA compounded over an earlier period, fixed rates, or on "Bank Rate" as in some existing mortgages) that may be more appropriate for meeting the needs of customers who prefer cash flow certainty, which are likely to be more stable than forward-looking rates based on market transactions on a single day, and easier to explain and understand.

No more new sterling LIBOR cash contracts from end of Q3 2020 – the FCA supports this target date set by the £RFR Working Group and will monitor firms' progress on this during 2020. However, the FCA acknowledges that this will involve significant infrastructure and documentation preparation, customer communication and staff exercises for some banks.

Communicating with customers about LIBOR and alternative rates or products

The FCA stresses that, when communicating with customers about LIBOR transition, firms should keep in mind their overarching obligation to communicate information to customers in a way that is clear, fair and not misleading. For example, firms should clearly present the benefits, costs and risks of alternative rates and ensure that relevant information is not disguised or hidden.

Firms should ensure that customers:

- have information about alternatives to legacy products in good time so as to make informed decisions about relevant products and risks; and
- are kept appropriately informed about the impact of LIBOR cessation on existing and new financial products and services.

Some customers may not fully understand the implications of alternative products so any communications should be tailored in light of the knowledge and experience of the intended audience. Staff may need additional training to ensure they can communicate effectively to customers and answer any queries competently.

The FCA offers comfort to firms indicating that it is possible to provide an objective overview of the benefits, costs and risks of a range of alternatives to a client's existing LIBOR-linked exposure, without offering a personal recommendation. However, in order to keep on the right side of regulation in this respect, it is important that firms ensure that their staff fully understand the boundary between providing information and advice.

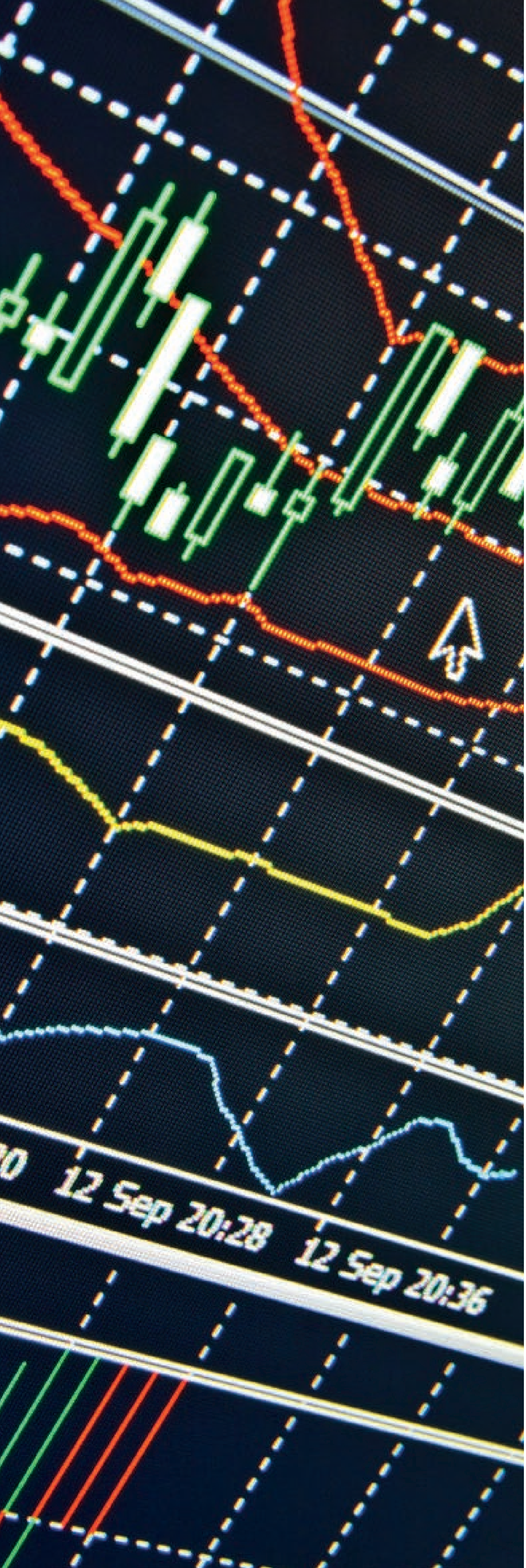
The FCA advises firms to engage with customers early to raise awareness and educate them on the general implications and timing of LIBOR transition for both existing and new contracts.

The FCA will challenge firms if:

- contracts contain small print which result in higher costs for customers (for example, by replacing LIBOR with a higher rate);
- customers are left with insufficient time to understand the options and make informed decisions; or
- customers are not provided with an objective overview of benefits, costs and risks of a range of alternative products to customers.

Firms investing on customers' behalf

The FCA stresses that it expects "buy-side" firms, such as asset managers, also to prepare for LIBOR transition. In particular, firms should have a plan in place for their investment strategy and best execution that considers the costs and implications of LIBOR transition to deliver in the best interests of customers.



What do you need to do now?

By publishing Q&As on conduct risk during LIBOR transition and relying on the SMCR to allocate a Senior Manager responsible for LIBOR transitioning, the FCA is clearly putting firms on notice that it will challenge them if they fail to meet these standards. The FCA will also hold individuals accountable where appropriate.

Firms that have not already done so should draw up their LIBOR transition plans now. As the FCA has highlighted, given that LIBOR transition will impact a firm's overall business, any transition plans should be considered and addressed in an appropriately coordinated way across the firm.

Next steps

We recognize that transitioning legacy LIBOR contracts to new RFRs is an immensely complex task, particularly in light of the many uncertainties still outstanding. A successful repapering exercise requires a precise understanding of the legal issues and the practical realities of the transition to the new RFRs across different currencies and financial products.

We have developed a "one-stop shop" solution to support clients with the discontinuation of LIBOR after 2021 with an advanced delivery toolkit to provide legal expertise using alternative legal resourcing through Hogan Lovells' Legal Delivery Center, Cognia Law and AI technology through our partnership with FTI Consulting.

More information on our advanced digital solution for LIBOR replacement is available here.

We have developed a "one-stop shop" solution to support clients with the discontinuation of LIBOR after 2021 with an advanced delivery toolkit to provide legal expertise using alternative legal resourcing.

Transitioning legacy LIBOR contracts to new RFRs is an immensely complex task

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"Noteholder or Not a Holder?"

Actions taken to seize control of a securitisation structure and the underlying loan portfolio declared void and of no effect.

Summary

Two recent High Court cases, *Business Mortgage Finance 6 Plc v Greencoat Investments Limited and others [2019] EWHC 2128 (Ch)* (the **Greencoat Case**) and *Business Mortgage Finance 6 Plc v Roundstone Technologies Ltd [2019] EWHC 2917 (Ch)* (the **Roundstone Case**) (together, the **Business Mortgage Cases**), have affirmed a number of principles relating to securities held through the clearing systems and the powers of receivers, including the following:

- The ability of noteholders to direct the trustee to act is set out in the terms of the transaction documents.
- The question of who has the ability to direct the trustee should be construed by reference to the specific terms of the transaction documents and how the notes are held within the clearing systems.
- Where noteholders wish to instruct the trustee, they must establish their entitlement to do so by delivering proof of holding satisfactory to the trustee. A trustee is not bound to act until it has received satisfactory proof of holding (and indemnification, if required).
- Typically the powers of a receiver are restricted to dealing with the assets over which the issuer has granted security to the trustee and do not extend to control over specific corporate matters, such as the ability to appoint and remove directors of the issuer.

The Business Mortgage Cases follow a number of recent cases which have concerned the validity of actions taken by parties purporting to be noteholders, who have sought to take control of securitisation transactions. The Business Mortgage Cases will be of interest to trustees, issuers and investors in providing greater clarity on the ability (or otherwise) of investors to direct a trustee. They also provide useful guidance as to the construction of "protection of third party" clauses in security documents and provisions governing the appointment of new trustees in trust deeds.

Facts and background

The Greencoat Case

In 2007, Business Mortgage Finance 6 PLC (**BMF6**) issued six classes of notes backed by a portfolio of commercial mortgages relating to property in the UK. BNY Mellon Corporate Trustee Services Limited (**BNY Mellon**) was appointed as trustee. In January 2019, Greencoat Investments Limited (**GIL**) launched a tender offer to purchase notes with an initial settlement date of February 28 2019 (subsequently postponed to July 10 2019). On March 18 2019, GIL announced it would make an initial cash payment to each of the holders of the notes equal to 1% of the purchase price in return for the immediate transfer of their rights under the notes. Although there was no evidence that such payment had been made or that any noteholders had transferred any of their rights in the notes prior to the proposed settlement date (or since), GIL purported to take certain steps to seize control of the securitisation. These purported steps included (i) appointing a trustee, (ii) directing BNY Mellon to declare an event of default, accelerate the notes and declare that the security was enforceable, (iii) appointing a receiver, (iv) removing BNY Mellon as note trustee, (v) replacing the directors of BMF6, and (vi) directing the sale of the underlying loan portfolio.

BMF6 sought declaratory relief against GIL and a number of other parties in relation to these arrangements. Judge Zacaroli held that there was no evidence that GIL was a noteholder within the meaning of the transaction documents when it purported to take the steps described above. The judge decided that the steps taken by the defendants to take control of the securitisation structure were invalid and of no effect.

Debt issues in global form

Where notes are issued in global form, the entirety of the debt issuance is represented by the global note. That global note is deposited with a "common depositary" who holds it on behalf of the clearing systems. The clearing systems record the dematerialized positions held in the notes by their participants. The holders of the economic interest in the debt will not themselves hold a note; instead the holders of the economic interest will either be direct participants in the clearing system or will hold their interest in the notes through a custodian or broker.

The Roundstone Case

The Roundstone Case concerned declaratory relief sought by BMF6 against Roundstone Technologies Ltd (**Roundstone**), the purported purchaser of the underlying loan portfolio. Roundstone asserted that it was a *bona fide* purchaser without notice when it acquired the rights to the receivables comprising BMF6's loan portfolio and the cash standing to the credit of BMF6's bank accounts. The sale and purchase agreement was executed by a receiver (appointed by GIL when it claimed to be the noteholder) in favour of Roundstone. Judge Nugee supported the judgment in the Greencoat Case that GIL was not a noteholder and that the receiver appointed by GIL had not been validly appointed. As a result, Judge Nugee decided that the purported receiver had no actual or ostensible authority to execute the sale. The court held that the sale was invalid and that Roundstone was not a *bona fide* purchaser without notice.

The issues

The meaning of a "Noteholder" and the importance of proof of holdings

The key issue in the Business Mortgage Cases was whether GIL was a 'noteholder' and therefore able to instruct the trustee. As the notes were in global form, the holder of legal title to the notes was the holder of the global note, i.e. the common depositary. In order to instruct the trustee by a written resolution, it was necessary for GIL to be a holder of the beneficial interest in the notes which it had sought to acquire through the tender offer. Judge Zacaroli held that a holder of the beneficial interests in the notes meant *"only those persons in whose name the Notes are held in the records of the clearing systems"*.

He supported this conclusion with reference to the definition of "*Instrumentholder*". He also relied on provisions of the trust deed and the global note to the effect that the trustee was entitled to rely on information provided by the clearing systems as to whether a particular person has an interest in the global note. The judge commented that, when ascertaining the beneficial owner of the notes, wherever the transaction documents envisage looking beyond the actual bearer of the global note, *"it goes no further than someone recorded as the holder… in the books of Euroclear or Clearstream."* As there was no evidence from the clearing systems that the positions had been transferred to GIL, GIL was not a holder of beneficial interests in the notes and did not have standing to instruct the trustee.

The judgment confirms that the meaning of 'noteholder' is a matter of contractual interpretation, properly informed by an understanding of how interests in global notes are recorded by the clearing systems. The judgment supports the view that any language which "cuts-through" to beneficial holders (i.e. the persons shown in the records of the clearing systems as the holder of a particular amount of the debt) is a practical matter. The court recognized that, as the ultimate beneficial interest in the notes can subsist through a chain of intermediaries, it is possible that *"neither the clearing systems themselves, nor their account holders, would have knowledge of the ultimate beneficiary."*

Most bond documents provide that investors are able to give instructions relating to the notes through a 'written resolution'. This takes effect as an extraordinary resolution if it is signed by holders of a sufficiently high threshold of the total bonds outstanding (usually 75% or 90%) and avoids the need for a formal investor meeting to obtain instructions. The Greencoat Case is a helpful reminder that the written resolution is valid if signed by the beneficial holders of the debt (provided the documents have 'cut-through' language) and that the written resolution does not need to be signed by the common depositary. The case also supports the conclusion that a trustee is not obliged to act unless it is satisfied that it is being instructed by the beneficiaries of the trust. This means that trustees will have the *"task of determining whether anyone other than the bearer of a global or definitive Note is a beneficial holder entitled to take action such as participating in a Written Resolution."* Where an investor claims to hold an interest under a global note, the investor must provide documentary proof in a form which can be reconciled to a holding of a direct participant in the clearing systems.

In his judgment, Judge Zacaroli referred to certain forms of evidence which may be provided by an investor to prove its entitlement in the notes. These include a *"current position statement taken from a recognised clearing system record keeping system."* Alternatively, the beneficial holder can ask the direct participant to procure that the clearing systems themselves deliver a SWIFT disclosure message to the trustee. If the investor is not itself a direct participant at the clearing systems, any position statement or SWIFT disclosure message will need to be accompanied by custody statements showing the note holding structure so that the trustee can reconcile the holding to the ownership claims of the purported holder. Judge Zacaroli summarized the verification process: *"the person beneficially entitled to notes held for it by an account holder at the clearing systems will provide evidence of that interest by instructing its account holder to provide such evidence via the clearing system directly to BNY [Mellon]".*

Validity of Actions

Aside from the fact that GIL was unable to prove that it was a noteholder at the time it purported to make the appointment by written resolution, the court also found other grounds to question the validity of actions taken.

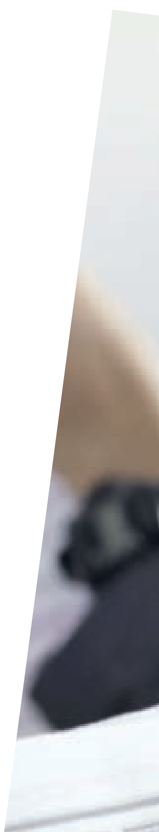
Appointment of New Trustees: the court held that this power was vested in BMF6 as issuer of the notes. Although there was a requirement for the appointment to be ratified by an extraordinary resolution of the most senior class of notes then outstanding, the noteholders did not have the power themselves to appoint a new trustee.

Appointment of co-trustee: the court found that (i) only the trustee had the power to appoint a co-trustee and (ii) the noteholders' power to direct the trustee did not extend to directing the trustee to conclude that something was in the interests of the noteholders (which was relevant because the trust deed only allowed the trustee appoint a co-trustee if it considered *"such appointment to be in the interests of the Instrumentholders").*

The court's commentary demonstrates that noteholders cannot expect to direct trustees to take actions or make determinations that the transaction documents expressly reserve to the trustee.

Trust Corporation: the trust deed provided that whenever there were more than two trustees, the majority of such trustees would be competent to exercise the rights and powers vested in the original trustee provided that a "Trust Corporation" was always included in such a majority. In this case, the entities purported to be appointed as co-trustees had not established that they met the criteria of being a Trust Corporation, and therefore could not exercise the trustee's powers on their own.

Removal of Trustee: the trust deed provided that where the only trustee in place is a Trust Corporation, the removal would not become effective until such time as a Trust Corporation was appointed as replacement trustee. As neither of the proposed replacements were a Trust Corporation, BNY Mellon's purported removal was invalid.



Powers of a receiver and protection of third parties: the steps taken by the purported receiver to remove the directors and company secretary of BMF6 were invalid primarily because the co-trustees had not themselves been validly appointed. However, the court noted that even if a receiver had been properly appointed, it would have no power to appoint and remove directors of BMF6. The judge highlighted that a receiver's power to act was limited to dealing with the charged property granted by BMF6 to the trustee. In an effort to delineate the extent of the receiver's powers, the court held that *"while the appointment of receivers will supersede the powers of the company (and thus the board of directors) to act in relation to the charged assets, it does not vest the receivers with any power to interfere in the shareholders' control over the appointment and removal of directors."*

Protection of Purchasers: Roundstone argued that it was a bona fide purchaser of the charged property for value without notice. It relied on the clause titled "*Protection of third parties*" to argue that it should enjoy protection in dealing with purported trustees and purported receivers. The court held that that clause only offered protection to purchasers dealing with validly appointed trustees and receivers *"in relation to the purported exercise of their powers even if events have not in fact occurred to make those powers exercisable."*

Final thoughts

These cases provide useful clarification for market participants on how important provisions relating to the exercise of investor rights and powers should be construed.

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Post-issuance impact reporting for green and social bonds – 2020 and beyond

Post-issuance impact reporting is a complex and resource-intensive task for green and social bonds issuers that many investors expect issuers to undertake. This article highlights some of the key guidance points on impact reporting in the latest ICMA guidelines and the best practices recommended by other industry bodies.

Background

Post-issuance impact reporting for green and social bonds has been a topic of tremendous interest among issuers and investors in the past few years, spurred on not just by the increase in issuance volumes across industry sectors, geography and issuer type, but also by the heightened scrutiny that investors are placing on the actual environmental and social impact of their capital markets investments. In research conducted by the Climate Bond Initiative (the CBI), it was found that 79% of green bonds issued in or before November 2017 have some form of impact reporting in place and the number of bonds with associated reporting has grown steadily since 2010 (with an average annual growth rate of 139%), when the first still outstanding green bonds came to market[1].

With the current climate crisis and its deleterious impact on wildlife, natural habitats, infrastructure, livelihoods and communities globally – from widespread wildfires in Australia to long-term droughts in Thailand and extreme heatwaves in Europe, each occurrence more severe than before – it is imperative that financial sector market participants urgently mobilize capital to finance businesses that produce measurable positive environmental and/or social outcomes, and influence businesses that are not doing so to change their practices for a sustainable future. However, there remains a question as to how debt capital market participants can really gauge the type and extent of positive outcomes achieved unless they are identified, measured and reported in an accurate, objective and clear fashion. In 2019, several industry-driven voluntary guidelines and updates were released, aimed at demystifying pre-issuance and post-issuance impact reporting for issuers and providing investors with the benefit of report transparency, consistency and comparability by attempting to harmonize the substance and format of impact reports. This note highlights some of the key principles featured in the recently-published ICMA papers titled *'Handbook on Harmonized Framework for Impact Reporting'* and *'Working Towards a Harmonized Framework for Impact Reporting for Social Bonds'* (June 2019) (together, the **ICMA Papers**) and the *Nordic Public Sector Issuers Position Paper on Green Bonds Impact Reporting* (January 2019) (the **NPSI Paper)**.

Post-issuance impact reporting – best practices

Post-issuance reporting on *actual* impact outcomes is not mandatory under current editions of the ICMA Papers, the NPSI Paper and the Climate Bonds Standard which, instead, require issuers to report on *expected* outcomes in order to be considered compliant with the relevant standard or guideline. The ICMA Green Bond Principles and the Social Bond Principles expect issuers to report annually on, amongst other things, the *expected* impact of the projects selected and state that *"issuers with the ability to monitor achieved impacts are encouraged to include those in their regular reporting"*. The NPSI Paper, which complements the ICMA Green Bond Principles, recommends that issuers undertake impact reporting *"based on expected environmental impact (ex-ante) from the project [they] finance or co-finance. Issuers that have the ability to provide impact reporting based on actual (ex-post) impacts, are encouraged to do so"*, actual impact reporting being an ambition[2] rather than a requirement.

Below is a summary of, and commentary on, some common themes in the ICMA Papers and the NPSI Paper that issuers and investors alike should consider when preparing or reviewing impact reports. It should be read alongside the original publications to allow for a more comprehensive understanding of their intricacies.

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1 *"Post Issuance Reporting In The Green Bond Market"*, Climate Bonds Initiative, March 2019 (the **CBI Report**)

2 "Reporting Principles – Expected impact, with actual impact as an ambition" – NPSI Paper, at page 14

The underlying project for the impact outcomes reported should be clearly identified. Where relevant and possible, the report should also include data on outcomes at a portfolio level.

- As the investors in one tranche of bonds may not necessarily have also invested in the issuer's other tranches of bonds, an impact report should, as far as possible, state the impact outcomes that are attributable – pro-rated, where applicable, to avoid overstating the outcomes – to the project funded[3] by the proceeds from the bond issuance. This would allow investors to track and evaluate the environmental and/or social impact of their investment in a particular tranche of bonds[4]. Although this could be challenging to achieve for repeat issuers with vast portfolios of projects (and potentially overwhelming for investors attempting to comprehend large volumes of methodologies and impact data), one-time and infrequent issuers should certainly strive to deliver impact reports with data that can be more precisely linked to a specific project.
- Where outcomes are aggregated at a portfolio or programme level (as an alternative to, rather than in addition to, project-level reporting), this should be clearly disclosed together with the reasons for doing so. For example, financial institutions with a green bond framework may find it difficult to provide meaningful impact reports at a project level because they do not own or manage the underlying projects.

Additionally, the bond proceeds are often on-lent to a large and diverse base of borrowers across a range of industry sectors and locations that would render reporting at a project level considerably cost-inefficient and impractical. Indeed, the NPSI Paper recognizes this issue and recommends that "for green bond frameworks where no commitment is made to reporting on smaller projects, i.e. projects below a defined investment size, project-by-project reporting is not required". Some other reasons issuers commonly cite for impact reporting on an aggregated basis are: (i) there are confidentiality considerations that restrict the issuer's ability to provide detailed information on the project, (ii) the issuer's competitive advantage may be undermined if project data is disclosed, (iii) bond proceeds are allocated on a portfolio, not project, basis, and (iv) individual projects are small in scale and would yield more meaningful results if aggregated with those produced by associated projects[5].

79% of green bonds issued in or before November 2017 have some form of impact reporting in place and the number of bonds with associated reporting has grown steadily since 2010.

3 The ICMA Papers recommend basing impact reporting on amounts allocated to projects, whereas the NPSI suggests using disbursed amounts as a basis for calculations to be conservative enough.

4 *"For non-dynamic portfolios where allocation is complete, each outstanding green bond will finance a designated sub-portfolio of projects. In such cases, the impact report should clearly state the estimated impact of each sub-portfolio/bond. Reported impact data should preferably and if feasible also be aggregated for all outstanding green bonds, so that is possible to associate all bonds from the same issuer with one aggregated set of impact results. Using the aforementioned approaches should serve to meet reporting demands both from investors which prefer impact reporting data relevant to the specific bond that they have purchased as well as from investors who prefer an aggregated approach"* (Source: NPSI Paper, at page 17)

5 In such cases, the World Bank recommends that *"when confidentiality or practicality prevents an issuer from reporting at individual project level, the issuer can aggregate the projects by categories according to its eligibility framework or other meaningful way to aggregate results. If this approach is chosen, the issuer is encouraged to provide more qualitative information about the portfolio as a whole, and where feasible supply quantitative results measures"* (Source: "Green Bond Proceeds Management & Reporting", A World Bank Guide For Public Sector Issuers, 2018)

Metrics used in impact reports should be clearly defined and reflect generally-accepted market practice where available.

- With a view to achieving greater consistency in metrics used in impact reporting, the ICMA Papers and the NPSI Paper also set out recommendations for core indicators relating to selected project categories which are eligible under the ICMA Green Bond Principles and Social Bond Principles. To the extent appropriate, and to facilitate comparability, issuers should strive to adopt the recommended metrics in their reporting. Should they choose to use alternative metrics, the issuer should explain their reasons for doing so and demonstrate the relevance of the selected metrics to the social/ environmental issue or outcome. However, even when comparing impact reports that present data using the same metrics, investors should remain cognisant of the fact that because assumptions and methodologies can vary significantly, a degree of caution must necessarily be applied when comparing the impact outcomes of projects or portfolios[6].
- Similarly, where anticipated data has been presented, issuers should also explain material deviations from their expected outcomes in their next (annual) report, as well as the anticipated effects of the underlying causes on the future performance of the project, and whether there are any mitigating measures in place. While reporting such information is not a requirement under the ICMA Papers or the NPSI Paper, the availability of such additional disclosure – in addition to information on the expected impact outcome for the next reporting period – would allow bondholders (and potential investors of future bond tranches and those in the secondary market) to calibrate their expectations and assess the performance of the project or portfolio at later stages. This could be of particular importance for long-term projects and useful for investors with narrower investment parameters.

The methodology used, and its assumptions and limitations, should be disclosed and explained clearly.

- The report should disclose in detail the methodology used and be transparent about the limitations and any assumptions built into it. Where there is no common method in the relevant industry for calculating a particular indicator used, the issuer may develop its own methodology to measure impact outcomes that are specific to its industry, project and/or geographical context. In this regard, the CBI recommends that as a matter of good reporting practice, context permitting, it can be beneficial for issuers to adopt an existing framework or work with experts to develop an individual methodology.
- To enhance the robustness and reliability of the data in impact reports, the ICMA Papers recommend that issuers make available any independent assessment from consultants, verification bodies and/or institutions with recognized expertise in the relevant subject matter. This should be of particular note for issuers who have chosen to modify established methodologies or have developed novel ones on their own to suit their specific circumstances.

The report should disclose in detail the methodology used and be transparent about the limitations and any assumptions built into it.

6 The NPSI Paper also states: *"While we strive to deliver reporting that is possible to compare and aggregate between issuers, we recognize the challenges related to different methodologies and metrics being used. Hence, we suggest caution to be exercised when such comparison or aggregation is undertaken."*

Hogan Lovells is proud to be a member of the ICMA Social Bond Principles Sub-Working Groups on Investor Survey and Impact Reporting for FY2019/2020.

The baselines and benchmarks used should be clearly defined and come from legitimate and independent sources.

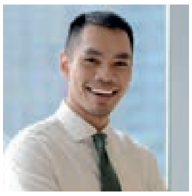
- Core indicators, although useful for understanding the impact of a project, can be misleading if they are presented without reference to relevant and reliable baselines and/or benchmarks. Contextual information, meaning baselines and benchmarks for the relevant geography (local, regional and national) and industry/project type, should be included as they provide an additional layer of granularity to the report and help investors to properly understand the extent to which outcomes have been achieved. For these reasons, the ICMA Papers[7] and the NPSI Paper emphasize that issuers should use baselines and be transparent about the sources of those baselines selected. In addition, the CBI recommends quantifying data in relation to an established benchmark or industry/company-specific baseline as one of the best practices for impact reporting[8].

Final thoughts

To help strengthen the integrity of the green and social bond market and to foster greater investor confidence in the authenticity of the financial product, issuers - regardless of the issue size, geography, project type and industry sector - should strive to provide investors with credible post-issuance impact reports to account for the environmental and/or social impact they promised at the issuance stage. Ultimately, the key principle that underlies several of the industry frameworks and guidelines is that of transparency. However, bearing in mind how time consuming and complex impact reporting can be, investors must necessarily tailor their expectations according to factors such as the size of the bond and how frequently the particular issuer accesses the capital markets.

Whether or not post-issuance impact reporting on actual outcomes will eventually be mandated under future editions of the ICMA Green and Social Bond Principles, the NPSI Paper or the CBI Standard remains to be seen. Given that development banks and other market leaders are keen to see the market grow even more rapidly – in terms of issue size and volume as well as issuer type across industries and geographies – to serve the funding demands of green, social and sustainability programmes across the globe, it would seem unlikely that additional reporting obligations will be imposed on issuers in the near future.

Contacts



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7 *"For comparability and transparency, it is highly recommended that issuers provide background on the methodology and assumptions used for the calculation of social impact indicators. Most notably, issuers are encouraged to explain if indicators represent incremental change between a baseline and a target (relative figure) or the total future figure without consideration of the baseline starting point (absolute figure)."* (Source: "Working Towards a Harmonized Framework for Impact Reporting for Social Bonds", ICMA, June 2019

8 In the March 2019 CBI Report, it was found that 79% of green bond issuers are measuring impact on an absolute basis, whereas only 3% are contextualising changes relative to a pre-determined baseline or benchmark, and 18% are disclosing some combination of the two.

Green ABS: a new opportunity

Building a climate-neutral, green, fair and social Europe is one of the four main priorities set out by the European Council in its strategic agenda for 2019-2024 (the **EC Agenda**). According to the EC Agenda, the success of the green transition *"will depend on significant mobilisation of private and public investments, on having an effective circular economy, and an integrated, interconnected and properly functioning European energy market"*.

The main green initiatives in Europe

Both stakeholder associations and the European Union have introduced various initiatives to facilitate the green transition in the financial markets.

The main initiatives include:

a) the market conventions adopted over time aimed at enabling access to debt capital markets in order to fund projects with a positive environmental impact (**Green Projects**). The main market convention is the Green Bond Principles adopted by the International Capital Markets Association (**ICMA**) and built on best market practices (**GBP**);

b) the nomination by the European Commission of a technical expert group on sustainable finance (**TEG**) to assist it in developing, *inter alia*, an EU classification system (**EU taxonomy**) to determine whether particular economic activity is environmentally sustainable, and an EU Green Bond Standard (**EU GBS**)[1]; and

c) the publication on December 11 2019 by the European Commission of the European Green Deal (**EGD**) which aims for the EU to become the first climate-neutral bloc in the world by 2050[2]. In order to achieve this, the European Commission envisages, *inter alia*, the implementation of the Sustainable Europe Investment Plan (**SEIP**)[3] which will mobilise at least €1 trillion in sustainable investments over the next decade in Europe[4].

The Securitization market

As regards securitizations, in January 2019 the new regulatory framework for securitizations in the EU[5] came into force (the **Securitization Framework**), setting common standards for all securitizations and defining criteria for "Simple, Transparent and Standardised" securitizations, thus confirming the European regulator's confidence in securitizations as a key tool for the growth and development of the European economy within the capital markets union.

The new Securitization Framework may have an important role[6] in developing securitizations aimed at financing Green Projects (**Green Securitizations**) and convincing investors to invest in environmental projects to achieve the EU's green targets.

To date, however, the demand for asset backed securities issued within the context of Green Securitizations has not been developed at the same level as the growing market for green, social and sustainability bonds.

One of the main problems in developing the Green Securitization market seems to be the lack of incentives in establishing or investing in Green Securitizations (and green finance in general) and of an agreed definition of Green Securitization.

Both stakeholder associations and the European Union have introduced various initiatives to facilitate the green transition in the financial markets.

1 On June 18 2019, the TEG published its report on EU GBS. The TEG proposes that the European Commission creates a voluntary, non-legislative EU GBS to enhance the effectiveness, transparency, comparability and credibility of the green bond market and to encourage the market participants to issue and invest in EU green bonds.

2 https://ec.europa.eu/info/publications/communication-european-green-deal_en.

3 In this respect, please see the European Commission's communication on the SEIP https://ec.europa.eu/commission/presscorner/detail/en/fs_20_48.

4 In particular, the SEIP pursues three main objectives: (i) increase funding for the green transition - mobilise at least €1 trillion to support sustainable investments over the next decade through the EU budget and associated instruments (in particular through InvestEU); (ii) create an enabling framework for private investors and the public sector to facilitate sustainable investments; and (iii) provide support to public administrations and project promoters in identifying, structuring and executing sustainable projects.

5 Regulation (EU) 2017/2402 of the European Parliament and of the Council of December 12 2017.

6 The new Securitisation Framework already introduces a light attention to green securitisation. According to paragraph 4 of Article 22 (Requirements relating to transparency) of Regulation (EU) 2017/2402, if the securitisation's underlying exposures are residential loans, auto loans or leases, the originator/sponsor shall publish the available information on the environmental performance of the assets financed by such loans or leases.

Types of Green Securitizations

There are three main types of Green Securitizations that can be identified in the market.

The first type of Green Securitizations is securitizations with "green" collateral, i.e. where the asset backed securities are backed by portfolios of green assets (e.g. mortgages to finance energy-efficient homes, electric vehicle loans/leases, solar leases and SME loans to fund environmental projects, etc.).

The second type is securitizations with "green" use of proceeds, i.e. where the proceeds of the asset backed securities are used for investment in Green Projects.

The third type is securitizations where the originator uses freed-up capital or leverage from a capital relief or synthetic securitisation to invest in "green" projects.

The second and third types of Green Securitizations are more similar to ordinary green bonds as the main requirement is that the proceeds or capital relief are utilised for green purposes, meaning that the securitised portfolio can be composed of non-green assets.

Developing a Green Securitizations market: the AFME Position Paper

With the aim of outlining the key factors needed to boost the development of a Green Securitizations market, on September 11 2019 the Association for Financial Markets in Europe (**AFME**) published a position paper on Green Securitizations (**AFME Paper**) which sets out the following observations below.

Definition of Green Securitization

The GBP defines a *"Green Securitised Bond"* as *"a bond collateralised by one or more specific Green Projects, including but not limited to covered bonds, ABS, MBS, and other structures; and aligned with the GBP. The first source of repayment is generally the cash flows of the assets".*

The GBP definition of "Green Securitised Bond" needs certain refinements to reflect, *inter alia*, the limited recourse nature of securitizations and the differences between covered bonds and securitizations. Moreover, as some green investors may have flexibility but many will only have a mandate to invest in securitizations collateralised exclusively by green assets, the definition of "Green Securitization" should exclusively refer to transactions collateralised by green assets, thus excluding securitizations where the proceeds of the securitization are applied towards, or regulatory capital or liquidity relief achieved is allocated to, Green Projects and the underlying collateral is not green[7].

The GBP requirements relating to the Green Projects selection and the use of proceeds would be satisfied in Green Securitizations by applying the proceeds arising from the issue of the asset backed securities to purchase portfolios of assets that comply with the relevant eligibility criteria meeting the requirements set out under the applicable green principles/framework[8].

Green incentives

The introduction of tax incentives, a preferential regulatory framework and other initiatives[9] will be fundamental to support the development of the Green Securitization market. For example, the introduction of improved regulatory capital treatment for green asset backed securities or tax incentives (to be introduced at national level) for investing in Green Securitizations could help promote Green Securitizations to all investor categories, not only to those with a green mandate.

Disclosure and reporting

With respect to green bond transactions, under GBP and the TEG report on EU GBS, monitoring and reporting on the compliance with the relevant green requirements are key elements to ensuring the development of the green bond market. However, since the Securitization Framework already sets out high disclosure requirements for securitizations[10], AFME does not consider it necessary to introduce specific additional monitoring and reporting obligations for Green Securitizations [11].

7 In any case, according to AFME, a securitisation transaction with non-green underlying collateral where the proceeds are invested in, or regulatory or liquidity capital relief allocated to, Green Projects, could qualify as a green bond under the GBP.

8 E.g. the eligibility criteria on a green RMBS transaction would typically include the minimum requirements relating to Energy Performance Certification (EPC) and on an auto loan transaction the minimum requirements relating to emissions standards.

9 According to the AFME Paper, other potential incentives could include: (i) reduced hair-cuts for central bank eligibility schemes; (ii) bespoke LCR limits; (iii) ongoing governmental and regulatory support by way of guarantees and the related regulatory benefit; and (iv) subsidies for establishing new Green Projects.

10 E.g. information related to environmental performance of "residential loans or auto loans or leases".

11 The repercussions of any breach of a green asset warranty would be limited to the usual repurchase obligations of an originator and the ongoing reporting would be no different from that of a standard securitisation transaction.

Need for specific eligibility criteria and trigger events

Green Securitizations need to set out green eligibility criteria to provide a framework for policing compliance with the applicable green principles or taxonomy of the underlying assets in order to avoid greenwashing practices.

On most public Green Securitizations, the green requirements will be tested on the closing date (or, in the case of a revolving transaction, on each transfer date) by the application of eligibility criteria that comply with the relevant green principles or taxonomy. Disclosure of the green aspects of the transaction in the prospectus would be limited to the description of the eligibility criteria and no bespoke green triggers or default events would be required[12].

However, additional green triggers or default events may be required in certain circumstances. For example, where the underlying collateral contains ongoing green obligations[13] the transaction would need to consider what the repercussions would be of a breach of any such ongoing obligation and how this should be reflected in reporting.

Evolution of green technology over time

As standards evolve over time, a securitization originally considered to be a Green Securitization could lose its green status, which would impact pricing and liquidity in the secondary market. Ongoing reporting and transparency will therefore, be important for when standards change on legacy transactions, and long-term securitization structures may require flexibility to evolve over time in order to remain green as standards develop and become more stringent[14]. Furthermore, any regulatory capital or similar incentives introduced for Green Securitizations should include grandfathering for securitizations that have ceased to be considered green over time as a result of the evolution of technology to mitigate any sudden detrimental impact on pricing and liquidity in the secondary market.

12 This would be the case for any transaction where the green aspects of the deal cannot change over time (e.g. any RMBS transaction or auto loan transaction where the relevant EPC certificate or emissions standard is certified upfront).

13 E.g. key deadlines for achieving a minimum energy efficiency improvement. In such cases, details of these ongoing obligations will likely need to be included in the relevant prospectus.

14 Consideration should be given to whether the appropriate green bond criteria and/or taxonomy requirements against which a portfolio is tested should be those that applied on the date the relevant receivable was originated to ensure that where a green portfolio is refinanced the new securitisation transaction could still qualify as a Green Securitisation.

The green securitization framework

Both GBP and TEG's report on EU GBS provide for the publication of a "green bond framework" by the issuer to explain how the issuer's strategy aligns with the environmental objectives, and provide details on all key aspects of the proposed use of proceeds, processes and reporting of green bonds. Whether a green framework will be required for Green Securitizations needs to be clarified. As the green framework is deemed by ICMA and TEG to be a key element in ensuring transparency for investors and market participants in general, we would expect the publication of a green framework will be needed in order to obtain the Green Securitization label[15].

Final thoughts

The green transition requires the engagement and the commitment of all capital markets players' for the implementation and the development of Green Securitizations.

The capital markets union (similar to the growth of the green bond market in recent years) may constitute a key part in achieving the EU's green targets, allowing the investment community to make full use of the emerging EU framework for sustainable investments.

With the aim of creating a fertile ground for the development of the Green Securitization market in Europe, the regulators and policymakers need to:

i) clarify the Green Securitization concept, including the specific requirements to be satisfied;

ii) permit originators to grant green loans with a quicker credit process and more favorable risk-weighting treatment;

iii) increase the appeal of Green Securitizations to enlarge the community of investors (currently limited to niche green funds);

iv) create a clear and certain labelling process for Green Securitizations; and

v) introduce incentives for Green Securitizations, allowing investors to benefit from more favorable pricing for Green Securitizations.

Protecting the existing green initiatives, **restoring** and increasing the interests of originators and investors in Green Securitizations and **funding** Green Projects seem to be the key elements needed in order to achieve the goal of a green transition and a more sustainable market; not just for securitizations but for the whole EU debt capital markets.

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As standards evolve over time, a securitization originally considered to be a Green Securitization could lose its green status, which would impact pricing and liquidity in the secondary market.

15 Taking into account the nature of securitisation transactions, regulators and policymakers should consider whether such framework should be prepared and published by the issuer, the originator or other parties of the transaction. As originators or other transaction parties may already have a green bond framework in place for green bond issues, coordination between green bond and Green Securitisation principles/regulations should also be considered.

The Luxembourg Stock Exchange updates its Rules and Regulations

On January 15 2020, the Luxembourg Stock Exchange published a new version of its rules and regulations which entered into force on January 31 2020 (the **New Rules and Regulations**). The New Rules and Regulations aim to reflect recent changes in the legal and regulatory framework introduced by the new law on prospectuses, as well as to take into account the feedback received by the Luxembourg Stock Exchange from market participants over the last few years. According to the Luxembourg Stock Exchange, the main objective of the New Rules and Regulations (besides the integration of mandatory legal changes) is to *"provide [its] clients with greater clarity, increased transparency and improved usability"*, which will also allow for faster turn-around times for submitted offering documents.

Changes to reflect the new Prospectus Regime

On July 2 2019, the Luxembourg Parliament adopted a new law on prospectuses, which entered into force on July 21 2019 (the **New Prospectus Law**). The purpose of the New Prospectus Law is to adapt national law following the entry into force of Regulation (EU) 2017/1129 of the European Parliament and of the Council of June 14 2017 (the **Prospectus Regulation**). The Grand Duchy of Luxembourg has simplified its specific regime for an alleviated prospectus (formerly known as a "simplified prospectus"). An alleviated prospectus is to be used in certain cases where the issuance would not fall under the obligation to draw up a prospectus pursuant to the Prospectus Regulation. The Luxembourg Stock Exchange has introduced in the New Rules and Regulations an appendix for such alleviated prospectuses[1], called "short-form" prospectuses. The New Rules and Regulations list the content requirements for such alleviated prospectuses in a user-friendly and concise manner.

The appendix relating to alleviated prospectuses is, for example, relevant for securities where the issuer is guaranteed by EU member states or their regional/local authorities, for money market instruments and for securities issued by public international bodies opting for a voluntary alleviated prospectus. Multilateral institutions which are not Public International Bodies (as defined in the New Rules and Regulations), and of which at least one OECD Member State is a member, benefit from the new short-form prospectus regime which requires no issuer disclosure. Under the previous rules and regulations, only fully fledged supranational issuers could benefit from this simplified regime. The same short-form prospectus is now also an option for non-equity securities issued in a continuous or repeated manner by credit institutions.

The New Rules and Regulations have also been amended to reflect changes made in the New Prospectus Law to align it with the format and language used in the Prospectus Regulation in order to achieve a coherent and harmonised, regime for offering documents generally.

Simplifying the Euro MTF Regime

The New Rules and Regulations further simplify the previous rules and regulations to impose fewer requirements in respect of listing on the Euro MTF. For example, the New Rules and Regulations now provide fourteen templates set out in appendices for both issuers and securities across all asset classes to be used as building blocks for the prospectus content. Previously, the rules and regulations of the Luxembourg Stock Exchange contained specific appendices with separate schedules which listed information to be included in a prospectus for warrants, credit-linked notes, certificates or structured notes, and which included a more complex mechanism of cross-referencing.[2]

Furthermore, the New Rules and Regulations set out lighter content requirements, which grant additional flexibility to issuers. In this respect it should be noted that the new risk factor requirements under the Prospectus Regulation are not applicable to issues on the Euro MTF.

In addition, the New Rules and Regulations now provide for more exemptions regarding listing on the Euro MTF as well as a single prospectus regime for debt securities which no longer makes a distinction between the wholesale and the retail market. A prospectus prepared for securities to be admitted to trading on the Euro MTF is similar in terms of format and wording to a prospectus prepared in accordance with the Prospectus Regulation, but there are fewer content requirements.

1 Appendix XIV (Short form prospectus) of the New Rules and Regulations

2 Appendixes IV, V and VI of the rules and regulations of the Luxembourg Stock Exchange dated November 2018

The New Rules and Regulations include lighter requirements for various items, in particular the following examples may be of interest.

- An issuer whose shares are already listed on a regulated or equivalent market may be exempt from disclosing certain information, such as its financial information, provided that it discloses the name of the market where such shares are admitted and their international security identification number. Similarly, if a guarantor is listed on a regulated or equivalent market, the disclosure of financial statements is waived.
- If an issuer which is a wholly owned subsidiary included in the consolidated accounts of its holding company issues securities that are unconditionally guaranteed by its holding company, such issuer does not need to provide its financial information, but only the relevant consolidated accounts. Similarly, with respect to guarantors who are in the scope of consolidation of group financial statements, disclosure of the group's financial statements will be sufficient.[3]
- There are now alleviated disclosure requirements for secondary issuances of debt securities, as set out in Appendix XIII to the New Rules and Regulations.
- With respect to convertible debt and derivative securities giving the right to acquire shares, the New Rules and Regulations are less stringent and only require the same level of issuer disclosure as that required of other debt securities. Previously, more detailed information had to be provided on the underlying shares, equivalent to that required for an equity listing, and the underlying shares had to be listed.
- The New Rules and Regulations now include a single schedule for all types of investment funds whether they are open-ended or closed-ended.
- With respect to derivative securities where the underlying is a fund with a NAV, such fund does not need to be a listed vehicle.
- Information can be generally incorporated by reference. For example, it is sufficient for financials to be disclosed through incorporation of the annual report by reference, and in the case of asset-backed securities, information on the underlying does not need to be fully disclosed in the prospectus provided such information is publicly available.

3 Appendix III of the New Rules and Regulations *(Guarantee building bloc)*

Changes related to AML/KYC rules

Currently, anti-money laundering and know-your-customer (**AML/KYC**) rules are being tightened across the globe, including in the EU through the EU AML Directives IV and V, which have now been transposed into Luxembourg laws and regulations.

In order to reflect this, the New Rules and Regulations include provisions relating to the fight against money laundering and terrorist financing. In particular, Article 107 of the New Rules and Regulations makes clear that "*the Luxembourg Stock Exchange may consider any Issuer's failure to comply with the AML/KYC obligations imposed by the Luxembourg Stock Exchange as a breach of the* [New Rules and Regulations]".

The compliance department of the Luxembourg Stock Exchange will conduct initial due diligence for each new issuer applying for a listing and/or an admission to trading of its securities on the Luxembourg markets. Applications for admission may be rejected if the results of the due diligence are not satisfactory or if the due diligence process cannot be completed.[4] In this respect, new specific KYC forms will need to be completed by first time issuers. However, the Luxembourg Stock Exchange has made clear that the listing/admission to trading process for existing issuers remains unchanged and that no AML/KYC form will need to be provided for new applications by existing issuers which have issued within the past 36 months. For such existing issuers, a revised risk classification process will be implemented in line with the new AML/KYC policy of the Luxembourg Stock Exchange. Depending on their risk classification, existing issuers will be contacted during the ongoing due diligence process in order to ensure that the mandatory filings and documentation are up-to-date.

In addition to the above, it should be kept in mind that where a prospectus has been approved in another EU Member State and passported to Luxembourg, in order to apply for admission to trading on the Luxembourg regulated market, the applicable KYC (to the extent required and not exempted) will need to be completed prior to listing.

Final Thoughts

The New Rules and Regulations have been aligned to recent legal changes and are presented in a clear and user-friendly way. This particular set of amended rules and regulations demonstrates the responsiveness and flexibility of the Luxembourg Stock Exchange and its capacity to listen to the needs of market participants. However, time will show how useful these amendments will be for market participants in practice.

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4 Article 311 (*Initial Due Diligence and Identification of the Issuers*) of the New Rules and Regulations

Implementation of prudential backstop – amendments to the CRR as regards minimum loss coverage for NPEs

In 2019 the non-performing loan (**NPL**) ratio of the EU banking sector declined to 3%. At the same time, both EU legislators and the European Central Bank (**ECB**) have forged ahead with their determination to address the NPL issue effectively and have implemented and aligned prudential and supervisory backstops for NPLs.

According to the European Banking Authority (EBA) report on NPLs published on November 8 2019[1] (the **EBA Report**), the quality of the EU banking sector has significantly improved over the last four years. Total NPLs decreased from over €1.15tn in June 2015 (6% as a percentage of total loans) to €636bn as of June 2019. The NPL ratio declined to 3%, the lowest ratio since the EBA introduced a harmonised definition of NPLs across European countries. The average coverage ratio slightly increased from 43.6% to 44.9% over the same period.

The EBA Report identifies three main reasons that caused the overall reduction in NPLs. First, the clear policy stance of the EBA and the whole supervisory community, and the Council of the EU's action plan played a key role. Second, the banks made efforts to enhance their NPL management capabilities. Lastly, the reduction was also helped by positive economic growth, low interest rates and decreasing unemployment. Countries with high NPL ratios have led the de-risking process of banks' balance sheets.

The first reason mentioned in the EBA Report (i.e. the supervisory attention and political determination to address the NPL issue) was also accompanied by a significant improvement in the co-ordination of the European bodies' approaches to reducing the banks' levels of non-performing exposures (**NPEs**)[2] by implementing a prudential backstop (**Pillar 1**) followed by a corresponding alignment of the already existing supervisory backstop (**Pillar 2**).

Implementation of prudential backstop – amendments to the CRR as regards minimum loss coverage for NPEs (Pillar 1)

Regulation (EU) 2019/630 of April 17 2019 amends the Capital Requirements Regulation (EU) 2013/575 (**CRR**) with regard to the minimum loss coverage for NPEs. On the basis of a common definition of NPLs, the new rules introduce a "prudential backstop" that is minimum loss coverage for the amount of money banks need to set aside to cover losses caused by future loans that turn non-performing.

The European regulatory bodies and legislators expect that the amendments will not only enhance the resilience of the Economic and Monetary Union to adverse shocks by facilitating cross-border private risk-sharing, but will also simultaneously reduce the need for public risk sharing. Furthermore, addressing potential future NPE accumulation is essential to strengthening the banking union as it is essential for ensuring competition in the banking sector, preserving financial stability and encouraging lending[3].

The prudential backstop requires a deduction from a bank's own funds where NPEs are not sufficiently covered by provisions or other adjustments. The specific applicable amount of insufficient coverage to be deducted from Common Equity Tier 1 (**CET 1**) items will be determined separately for each non-performing exposure pursuant to the criteria set out in new Article 47c of the CRR.

1 EBA Report on NPLs – Progress made and challenges ahead, https://eba.europa.eu/eba-shows-efforts-improve-eu-banks%E2%80%99-asset-quality-have-proven-successful-pockets-risks-remain.

2 The terms "non-performing exposure" (NPE) and "non-performing loan" (NPL) are used interchangeably in this document. However, the CRR, as well as the ECB's expectations, address NPEs, which are broader and include debt instruments.

3 Cf. Recital (3) of Regulation (EU) 2019/630 of April 17 2019.

The prudential backstop and therefore Pillar 1 NPE treatment fully applies: (i) after 3 years of NPE status for unsecured NPEs; (ii) after 9 years of NPE status for secured NPEs which are secured by immovable collateral and residential loans guaranteed by an eligible protection provider as defined in the CRR; and (iii) after 7 years of NPE status for other secured NPEs. Moreover, it also specifies paths to full implementation (i.e. 100% coverage) for unsecured and secured exposures before 3/7/9 years of NPE status (as stipulated in Article 1 of Regulation (EU) 2019/630 amending CRR).

In order to apply the prudential backstop, the CRR introduced a clear set of conditions for the classification of NPEs. As the Commission Implementing Regulation (EU) 2014/680 already lays down criteria concerning NPEs for the purposes of supervisory reporting, the classification of NPEs builds on that existing framework. Implementing Regulation (EU) 2014/680 refers to defaulted exposures as defined for the purpose of calculating own funds requirements for credit risk and impaired exposures pursuant to the applicable accounting framework. As forbearance measures might influence whether an exposure is classified as non-performing, the classification criteria is complemented by clear criteria on the impact of forbearance measures. Regulation (EU) 2019/630 therefore provides that a forbearance measure granted to a NPE should not discontinue the classification of that exposure as non-performing unless certain strict discontinuation criteria are fulfilled.

In order to apply the prudential backstop, the CRR introduced a clear set of conditions for the classification of NPEs.

The main amendments to the CRR are as follows:

- Point (m) with regard to NPEs has been added in Article 36(1).
- Article 47a on NPEs, Article 47b on forbearance measures and Article 47c on deduction for NPEs have been inserted.
- Article 159 on Treatment of expected loss amounts and Article 469a on derogation from deductions from CET 1 items for NPEs have been inserted.

To facilitate a smooth transition toward the new prudential backstop, the new rules will not be applied in relation to exposures originated prior to April 26 2019. Where competent authorities ascertain on a case-by-case basis that, despite the application of the prudential backstop for NPEs established by Regulation (EU) 2019/630 amending the CRR, the NPEs of a specific institution are not sufficiently covered, it is possible for them to make use of the supervisory powers provided for in the Capital Requirements Directive IV (**CRD IV**), including the power to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements. Therefore, it is possible, on a case-by-case basis, for the competent authorities to go beyond the requirements laid down in Regulation (EU) 2019/630 amending the CRR for the purpose of ensuring sufficient coverage for NPEs.

Alignment of supervisory backstop – ECB's communication on supervisory coverage expectations for NPEs (Pillar 2)

In its communication on August 22 2019[4], the ECB decided to align its supervisory expectations for NPEs with the legally binding Pillar 1 provisioning requirements set out in Regulation (EU) 2019/630 amending the CRR as regards minimum loss coverage for NPEs.

The ECB's Pillar 2 approach to coverage expectations for NPEs at present consists of:

- Guidance to banks on NPLs published in March 2017 (**ECB Guidance**), whereby the ECB expects banks to set internal coverage thresholds for NPLs depending on their risk profile.
- The addendum to the ECB Guidance to banks on NPLs (**Addendum**) published in March 2018, which clarifies the ECB's supervisory expectations for prudential provisioning of new NPEs (i.e. exposures classified as non-performing according to the EBA's definition from April 1 2018 onwards).
- Supervisory expectations for provisioning of NPE stock (i.e. exposures classified as NPE on March 31 2018), which were communicated in a press release issued on July 11 2018.

In order to align the main differences between the CRR Pillar 1 NPE treatment and the ECB's Pillar 2 approach, the ECB will adjust the Pillar 2 approach for new NPLs.

The scope of the ECB's supervisory expectations for new NPEs under the Pillar 2 approach as communicated in the Addendum will be limited to exposures not subject to Pillar 1 treatment – i.e. to NPEs arising from loans originated before April 26 2019. NPEs arising from loans originated from April 26 2019 onwards will in principle be subject solely to Pillar 1. However, the ECB may still apply Pillar 2 measures if the specific circumstances warrant them.

In order to make the two approaches more consistent, the relevant time frames for NPEs arising from loans originated before April 26 2019 will be changed from 2 and 7 years to 3, 7 and 9 years, to align these time frames with those in the Pillar 1 approach. More precisely, NPEs subject to the Addendum are expected to follow the 3/7/9-year vintage count for unsecured/secured (other than by immovable property)/secured by immovable property, with paths to reach the full implementation as under the Pillar 1 approach.

Lastly, for parts of NPEs guaranteed or insured by an official export credit agency, the expected linear path to full implementation has been removed – i.e. following the Pillar 1 treatment, there are no coverage expectations until the 7-years vintage bucket and the coverage expectation of 100% is only applicable to export credit exposures after more than 7 years of NPE status.

4 EBA communication on supervisory coverage expectations for NPEs - https://www.bankingsupervision.europa.eu/press/letterstobanks/ shared/pdf/2019/ssm.supervisory_coverage_expectations_for_NPEs_201908.en.pdf.

Final thoughts

It should be noted that the legally binding Pillar 1 approach only applies to exposures that arose on or after April 26 2019. The ECB's supervisory coverage expectations for NPEs under the Pillar 2 approach, however, are not legally binding and follow a 3-step approach. In particular, the expectations communicated are: (1) a starting point for a supervisory dialogue; (2) dependent on a case-by-case assessment after being thoroughly discussed during the supervisory dialogue (including analysis of bank-specific circumstances); and (3) a supervisory measure may be applied under the Pillar 2 approach in the ECB's Supervisory Review and Evaluation Process (**SREP**) cycle. It therefore remains to be seen to what extent the prudential backstop under the Pillar 1 approach can really contribute to the reduction of NPEs.

Finally, banks need to prepare themselves for the transmission of more detailed information as regards NPEs to the regulator on a regular basis as requested according to the current Draft Implementing Technical Standard published on October 16 2019 (which include three new templates for NPEs loss coverage into COREP (Common Reporting[5]) and the latest EBA Guidelines on disclosure of non-performing and forborne exposures[6] which require banks to provide, *inter alia*, information on credit quality of NPEs and collateral valuation.

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Banks need to prepare themselves for the transmission of more detailed information as regards NPEs to the regulator on a regular basis...

5 EBA Consultation Paper – Draft Implementing Technical Standards on supervisory reporting requirements for institutions under Regulation (EU) No 575/2013 dated October 16 2019, page 9.

6 EBA Final Report – Guidelines on disclosure of non-performing and forborne exposures dated December 17 2018.

EMIR and SFTR reporting – two sides of the same coin?

With the start date for reporting in relation to securities financing transactions (**SFTs**), such as repos and securities lending, fast approaching, counterparties will need to ensure the necessary systems are in place for their compliance with the Securities Financing Transactions Regulation ((EU) 2015/2365) (**SFTR**). While previous experience of implementing systems for the analogous reporting requirement for derivative transactions subject to Regulation (EU) No 648/2012 (**EMIR**) will provide a framework for preparing for SFTR reporting, there are some key differences between the two reporting regimes.

In response to the global financial crisis, the European Union sought to enhance transparency of some of the more opaque parts of the financial system, including through the enactment of EMIR, as amended by Regulation (EU) 2019/834 (**EMIR Refit**), and SFTR. While EMIR aims to increase transparency of the over the counter (**OTC**) derivatives market, SFTR looks to do the same in respect of securities financing markets.

The way in which these regulations seek to achieve transparency is by imposing obligations on counterparties to derivative transactions and SFTs[1] to report trade details, with obligations under SFTR starting to come into force in April this year. Counterparties must provide these trade details to a trade repository registered with, or recognized by, the European Securities and Market Authority (**ESMA**) upon entry into, modification or termination of the contract.

The key concerns for the market have centered around differences between the regimes, with SFTR requiring more than EMIR, and how delegated reporting imposed by the relevant legislation will operate in practice.

Following a review of the legislation in the context of EMIR Refit, such reporting requirements were deemed to impose disproportionate costs on smaller counterparties.

Reporting under EMIR (as amended by EMIR Refit):

Prior to the introduction of EMIR Refit, the requirement to report derivative contracts under EMIR applied equally to both financial counterparties (**FCs**) and non-financial counterparties (**NFCs**), though it has always been possible for a counterparty to delegate reporting. Following a review of the legislation in the context of EMIR Refit, such reporting requirements were deemed to impose disproportionate costs on smaller counterparties. Accordingly, EMIR Refit amended the reporting obligation such that, from June 18 2020, FCs that enter into an OTC trade with an NFC that is below certain clearing thresholds (an **NFC-**) will be "solely responsible" for reporting those trades on behalf of both parties. (Please see the Annex to this article for the relevant clearing thresholds.)

Reporting under SFTR:

Under SFTR, the requirement on FCs and NFCs to report details of an SFT is being implemented in staggered phase-in dates depending on the status of the relevant counterparty, with phase 1 applying from April. (Please see the Annex for the relevant phase-in dates). Similarly to EMIR, as amended, where an FC enters into an SFT with an NFC that is considered a small or medium sized entity (**SME NFC-**) for accounting purposes, the FC will be responsible for reporting the trade details for both parties. Given that the reporting obligation on NFCs under SFTR is not due to kick in until January 11 2021, however, the FC will not be required to report on behalf of an SME NFC- before then. If an SFT is between an FC and an NFC (excluding an SME NFC-), both counterparties are mandatorily obliged to report, but it is possible for the NFC to delegate reporting to its FC counterparty in the same way that parties to derivative transactions can do under EMIR.

1 Pursuant to article 3(11) of SFTR, an SFT means a repurchase transaction, a securities or commodities lending or borrowing transaction, a buy-sell back or sell-buy back transaction and a margin lending transaction.

Key differences between EMIR and SFTR reporting:

Extra-territoriality

One of the key differences between reporting under EMIR and SFTR is the extraterritorial application of the reporting obligation. EMIR does not place any reporting obligation on third-country counterparties, even if such a counterparty is entering into a derivative transaction with an EU entity. SFTR reporting on the other hand applies extraterritorially in two circumstances: (i) when a non-EU branch of an EU entity enters into an SFT and (ii) when an EU branch of a third-country entity enters into an SFT. Nevertheless, even though EMIR reporting does not apply to third-country entities, an EU counterparty entering into a derivative contract with a third-country counterparty will still seek certain minimum information from its counterparty to ensure compliance with EMIR.

Reporting requirements

Another key difference between the two reporting regimes is the level of detail concerning trades required to be included in trade reports. In particular, for SFTR, the details of any collateral being posted and any reuse of such collateral is required to be reported. The trade report expected to be made in relation to derivative transactions is set out in the Annex to Commission Delegated Regulation (EU) 2017/104, which requires details of any initial and/or variation margin being posted, including the currency of the collateral and, if relevant, the value of any excess collateral. In comparison, the trade report in relation to SFTs set out in the Annex to Commission Delegated Regulation (EU) 2019/356 (**SFTR RTS**) not only contains fields for the amount of collateral being provided, but also the quality of the collateral (e.g. investment grade), information on the issuer of the collateral if securities are used and details on the reuse of such collateral. In accordance with Article 4 of the SFTR RTS, it is the counterparty receiving the collateral that is expected to complete the relevant fields of the trade report relating to collateral reuse.

The extensive reporting requirements under SFTR in respect of collateral reuse have arisen in response to a concern of regulators that collateral is often used multiple times resulting in 'complex collateral chains', posing a risk to financial stability. By increasing transparency, it is hoped that this risk can be mitigated and confidence of counterparties to trades can be increased, especially in instances of bankruptcy.

For further details on the differences between the trade reports, and additional differences between the two regimes, a comparison table is set out in the Annex below.

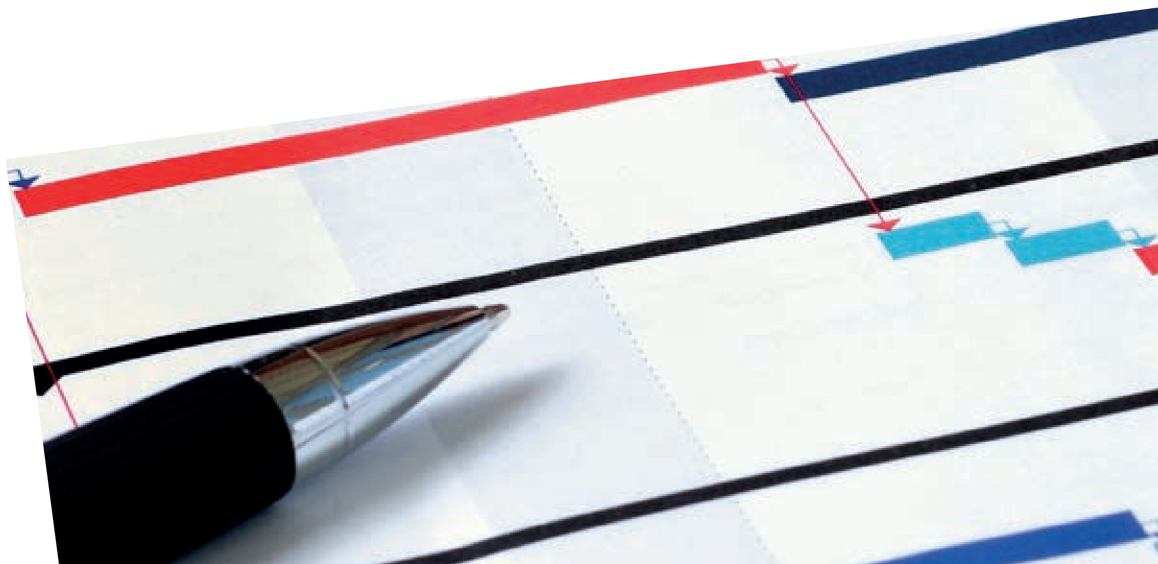
Master Reporting Agreement:

In order to provide a framework for the delegation of reporting under SFTR and EMIR, a working group comprised of various industry bodies (including the Association for Financial Markets in Europe, the Futures Industry Association, Inc., the International Capital Markets Association, the International Securities Association and the International Swaps and Derivatives Association, Inc.) published the Master Regulatory Reporting Agreement (**MRAA**) on December 19 2019. The MRAA is a template agreement that can be used by two counterparties to derivative transactions and/or SFTs and which designates one of the parties as reporting entity so as to make clear how both parties' reporting obligations under EMIR and SFTR will be met.

The MRAA is divided into two main sections and provides for both elective delegated reporting (**Delegated Reporting**) and mandatory reporting (**Mandatory Reporting**). In respect of EMIR, if an FC is required to report on behalf of an NFC- or, in respect of SFTR, if an FC is required to report on behalf of an SME NFC-, provisions to deal with such situation are set out in the Mandatory Reporting section. If no such mandatory reporting is applicable, but the counterparties wish to delegate reporting, the relevant provisions have been included in a section entitled 'Delegated Reporting'. A considerable amount of optionality is built into the MRAA, for example, if the counterparties are entering into both derivative transactions and SFTs, they can elect for Mandatory Reporting to apply in respect of derivative transactions (if one party is an FC and the other party is an NFC- for the purposes of EMIR) and Delegated Reporting in respect of SFTs (if the NFC- is not an SME NFC- for the purposes of SFTR reporting).

Each section includes an obligation on the non-reporting party to provide relevant information for completing the trade report to the reporting party. However, if the non-reporting party fails to provide such information and Delegated Reporting is applicable, the reporting party will be under no obligation to submit such data on its behalf, whereas if such a scenario occurs and Mandatory Reporting is applicable, the non-reporting party will breach its obligations under the MRAA, but the reporting party will still be subject to its regulatory reporting requirements.

There are two product specific annexes to the MRAA; one for derivative transactions (the **Derivatives Annex**) and the other for SFTs (the **SFT Annex**). There is considerable overlap between the annexes, in particular (i) the ability to select which type of reporting applies (either Delegated Reporting or Mandatory Reporting), depending on the type of derivative transaction or SFT being entered into, and (ii) the ability to elect for the automatic transition from Mandatory Reporting to Delegated Reporting (and vice versa) to address a situation where the status of a counterparty changes. There are a few notable differences, however, including the provision of an opt-out election for an NFC- that has invested in a reporting system in the Derivatives Annex and the ability to opt-out of producing "backloading" reports on behalf of the non-reporting party in the SFT Annex (i.e. reports in relation to certain legacy transactions that remain live after the reporting start date).



Final thoughts

The differences between SFTR and EMIR reporting, as highlighted above, are a primary concern for the market, especially in respect of the information relating to collateral reuse that must be included in an SFTR trade report. There remains some uncertainty around the interaction between these regimes and what SFTR requires. Other key questions we are being asked by parties to SFTs are as follows:

- Could a credit support arrangement in connection with a derivative transaction fall within the scope of SFTR reporting as well as EMIR? Can a party comply with its reporting obligations under both the EMIR and SFTR regimes by submitting a report under only one regime in the case of such a transaction?
- How specific does the reporting of collateral reuse need to be, given the parties will not necessarily know from the effective date of a transaction what the collateral will be used for in the future? Do the parties need to update reporting when use of the collateral changes?
- What obligations apply where one party to an SFT is required to report under SFTR but its counterparty is not yet caught because the relevant phase-in date is in the future? Will this lead to difficulties in obtaining reporting information as the other party will not be obliged to report and, therefore, will be less incentivised to provide such information?

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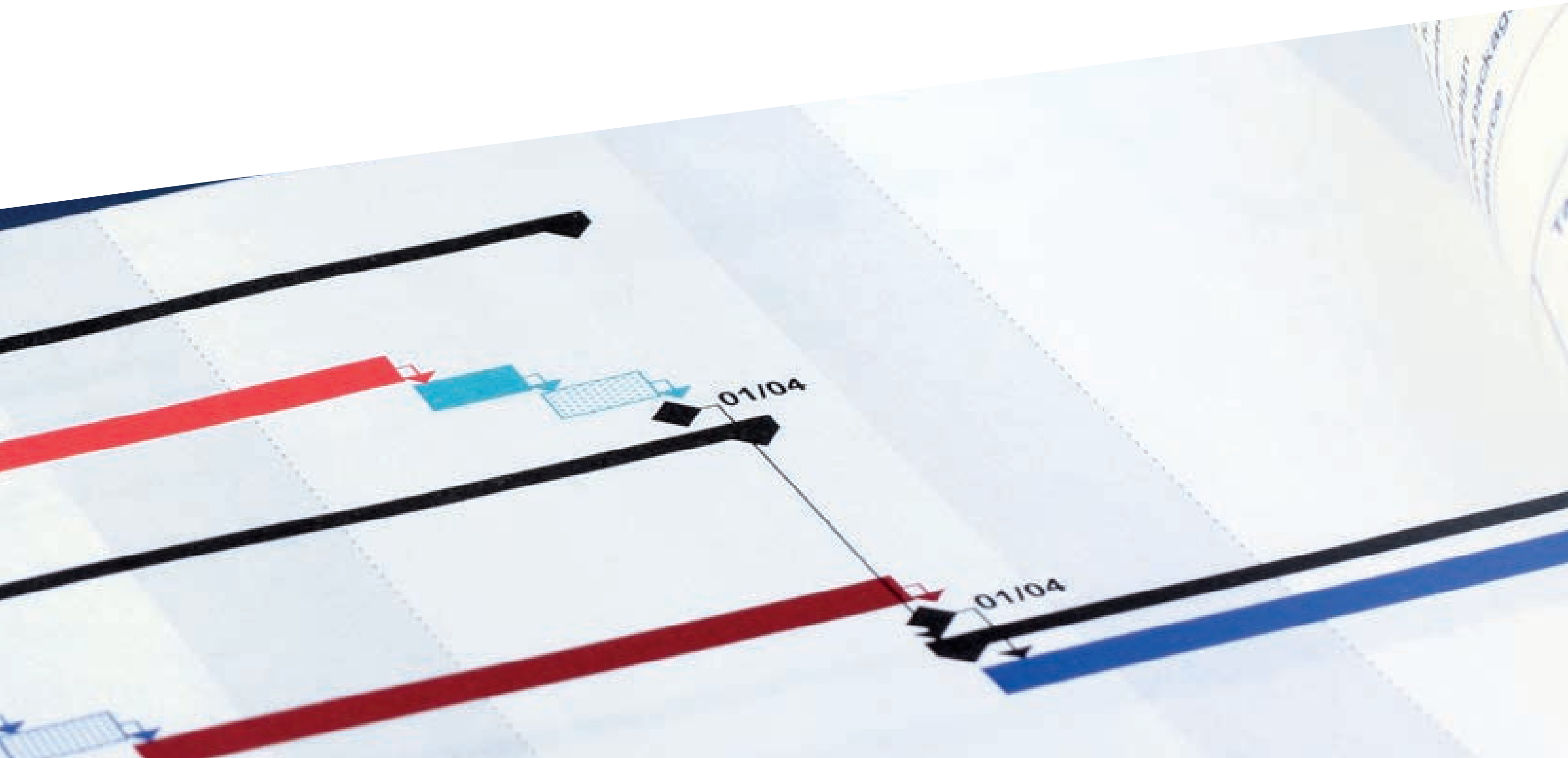

Annex

<table>
<tr><th></th><th colspan="3">EMIR</th><th colspan="3">SFTR</th></tr>
<tr><td>1 Which transactions fall within the scope of the regulation?</td><td colspan="3">Derivative contracts (including both OTC and exchange-traded derivatives).</td><td colspan="3">• Securities and commodities lending and borrowing;
• Repo transactions;
• Buy-sell backs / sell-buy backs; and
• Margin lending.</td></tr>
<tr><td>2. When must a transaction be reported?</td><td colspan="3">Conclusion, modification or termination of the transaction.</td><td colspan="3">Conclusion, modification or termination of the transaction.
(See section 7 below for phase-in dates.)</td></tr>
<tr><td rowspan="5">3. Who is required to report the transaction?</td><td>Party</td><td>Party</td><td>Reporting Obligation</td><td>Party</td><td>Party</td><td>Reporting Obligation</td></tr>
<tr><td>FC</td><td>FC</td><td>Both</td><td>FC</td><td>FC</td><td>Both</td></tr>
<tr><td>FC</td><td>NFC+</td><td>Both</td><td>FC</td><td>NFC+</td><td>Both</td></tr>
<tr><td>FC</td><td>NFC-</td><td>Both
*FC as of June 18 2020</td><td>FC</td><td>SME NFC-</td><td>FC</td></tr>
<tr><td colspan="3">An NFC- means a non-financial counterpartythat does not meet any of the clearing thresholds.
A clearing threshold is met if the entity's aggregate month-end average position at group level in derivative contracts (excluding for hedging purposes) is:
• ≥ EUR 1 billion: for either credit and equity derivatives; or
• ≥ EUR 3 billion: for either interest rate, foreign exchange or commodity derivatives.</td><td colspan="3">An SME NFC- means a non-financial counterparty that has at least two of the following:
• Balance sheet total of < EUR 20,000,000;
• Net turnover < EUR 40,000,000; or
• Average number of employees during year < 250.</td></tr>
<tr><td>4. By when does the transaction need to be reported?</td><td colspan="3">The following business day (T+1)</td><td colspan="3">T+1</td></tr>
</table>

<table>
<tr><th></th><th>EMIR</th><th colspan="2">SFTR</th></tr>
<tr><td>5. Number of fields to populate in the trade report:</td><td>129</td><td colspan="2">153 (product dependent)</td></tr>
<tr><td>6. What information needs to be included in the report?</td><td>The trade report is split into two sections: 'Counterparty Data' and 'Common Data'.

Counterparty Data:
• This section includes counterparty details (e.g. FC or NFC), general contract details (e.g. is it at a hedging transaction, mark to market value of the contract and details on the posting of collateral).

Common Data:
• The common data sets out the general commercial terms of the contract, including maturity date, termination date and price. There are also fields specific to the type of derivative (e.g. commodity derivatives, options and credit derivatives).</td><td colspan="2">The trade report is split into four sections: 'Counterparty data', 'Loan and collateral data', 'Margin data' and 'Re-use, cash reinvestment and funding sources'.

Counterparty data:
• Similar counterparty details to the EMIR trade report, in addition to branch office details if relevant.

Loan and collateral Data:
• This section sets out the details of the trade, including the collateral arrangements, such as substitution of collateral, whether collateral is available for reuse and any haircut.

Margin data:
• In respect of cleared SFTs, details of initial margin, variation margin and excess collateral.

Re-use, cash reinvestment and funding sources:
• One of the main details to be included in this section is details of collateral reuse (e.g. value of reused collateral and currency).</td></tr>
<tr><td rowspan="5">7. What are the key deadlines?</td><td rowspan="5">Fully implemented</td><td>Implementation date:</td><td>Entity:</td></tr>
<tr><td>April 11 2020</td><td>Banks and investment firms</td></tr>
<tr><td>July 11 2020</td><td>Central counterparties and Central Securities Depositories</td></tr>
<tr><td>October 11 2020</td><td>Remaining FCs (eg. Insurance/ reinsurance firms, UCITs, AIFs and pension schemes) and third country entitites</td></tr>
<tr><td>January 11 2021</td><td>NFCs</td></tr>
</table>

Mind the Gap – Cryptocurrency and its relationship with the Mexican financial system

The financial technology industry in Mexico has been thriving over the last few years, and the regulation that has followed seeks to continue this innovative trend, while protecting the financial system and its users from any potential risks associated with these new technologies.

The Mexican Financial Technology Institutions Law (**Fintech Law**) was published on March 9 2018, in order to build a regulatory framework around the development of innovative financial services and the operation of virtual assets (such as cryptocurrency). The Fintech Law was intended to increase the level of competition and financial inclusion, as well as protecting the wellbeing of innovative financial services consumers, in order to put Mexico at the forefront of the industry.

The provisions written into the Fintech Law mainly focus on regulating the organization, operation, functioning and authorization of companies that offer alternative means of access to finance and investment, the issuance and management of electronic payment funds and the exchange of virtual assets (**Financial Technology Institutions or FTIs)**, as well as those providing innovative financial services through a regulatory sandbox. A regulatory sandbox is a special status whereby conventional regulation is not applied in order to test new business models.

The Fintech Law nevertheless provided for secondary regulation to be published by several Mexican government agencies. One of the most anticipated was the piece of regulation regarding virtual assets with which FTIs would be able to operate, as well as the operations they would be able carry out with such assets, including the information that would need to report to financial authorities.

The regulation was required to be released within 12 months of the publication of the Fintech Law. Accordingly, on March 8 2019, the Bank of Mexico (**Banxico**) published a directive containing the "General Provisions applicable to Credit Institutions and Financial Technology Institutions regarding Transactions carried out with Virtual Assets" (**Directive 4/2019**).

The foreword to Directive 4/2019 states that the use of virtual assets in financial services offered to the public can be problematic for its users due to their complexity as well as the difficulty in understanding the factors that determine their price. Moreover, if established financial institutions begin to offer virtual-asset-related financial products to their clients, it may generate a false sense of security regarding such inherent risks.

The drafting of Directive 4/2019 also considered that the use of virtual assets entails a significant risk regarding money laundering and terrorism finance. This is due to the ease of transferring virtual assets to different countries, as well as the absence of consistent global controls and prevention measures.

With that in mind, the provisions contained within Directive 4/2019 intend to build a healthy gap between the Mexican financial system and virtual assets so that such financial services users are not exposed to their inherent risks or unwittingly aiding illegal activities such as money laundering.

Notwithstanding the above, through Directive 4/2019, Banxico also states that it seeks to encourage and take advantage of new technologies that can promote efficiency or performance. This is as long as these technologies are used in the context of the internal operations of banks and Financial Technology Institutions, and which do not lead to a significant increase in their operational or financial risks.

Therefore, banks and FTIs are permitted to carry out operations involving virtual assets to the extent that they are regarded as internal operations under the provisions of Directive 4/2019. However, financial institutions must at all times prevent the risk from being transmitted directly or indirectly to their clients while carrying out transactions with virtual assets.

Although banks and FTIs are not permitted to provide exchange transmission depository services regarding virtual assets directly to their clients, they might be able to provide such services through indirect means that allows risk to be diverted away from their client base and from the financial system. On the other hand, current regulation does not prevent companies from offering services related to virtual assets, such as buying and selling, as long as such companies are not legally considered financial institutions, such as FTIs, or carry out activities reserved for them.

In any case, the business model for financial institutions would have to be reviewed by the applicable financial authorities. Furthermore, banks and FTIs are required to request authorization before they are permitted to carry out these types of internal operations involving virtual assets. The requirements regarding the application for such authorization are outlined in the provisions and under the terms of Directive 4/2019.

Final thoughts

The Mexican financial technology ecosystem has flourished over the last few years through innovation, competition and inclusivity. As a result of the new regulations introduced by Banxico, there is confidence that building a healthy gap between the risks associated with virtual assets and financial services users will continue the flow of those same factors that have produced one of the best environments for financial technology in Latin America.

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The New Brazilian Economic Freedom Act

In January 2019, Jair Bolsonaro took office as the new president of Brazil. The Bolsonaro administration has indicated that changes to the Brazilian legal framework will be a strategic priority in the rebuilding of Brazil's economy in the wake of the system-wide corruption investigations that resulted in the bankruptcy or near-insolvency of several key Brazilian companies, particularly in the construction and oil & gas services sectors. To achieve its desired goals, the Brazilian federal government is pushing a legislative agenda to improve the business environment, foster competitiveness and bolster the interest of foreign investors.

As the largest economy in Latin America, Brazil has always been on the radar of international investors, especially in the last decade. Despite a recent history of economic recession and corruption scandals, the country is implementing a number of changes to improve legal certainty and attract or retain investments. In this regard, on September 20 2019, Brazilian Provisional Measure No. 881, also known as the Brazilian Economic Freedom Act (the **Act**), became Law No. 13,874/2019. The Act aims to improve the business environment and reduce bureaucracy, and is part of a broader legislative scheme to revamp the economy.

The summary below sets forth the main changes brought about by the Act that we believe are relevant to our international clients and to foreign investors.

Investment Funds

The Act provides a number of regulatory changes in order to bring the structure of local investment funds closer to international standards. One of the most notable changes is the possibility of limiting a quotaholder's liability to the value of their interest in the fund (similar to the liability of quotaholders in Brazilian limited liability companies). Prior to the Act, quotaholders' liability was generally uncapped, limited only by the proportion of their holdings with respect to the other quotaholders of the fund in question, with few exceptions such as with respect to real estate funds (where liability was limited to a quotaholder's interest in the fund). After the enactment of the Act, a fund's organizational documents may provide limited liability for investors so that they would not have to disburse additional money if the fund underperforms or requires additional capital. These regulatory changes are expected to improve the legal environment for Brazilian and international investors, stimulating the use of local investment vehicles and thus increasing investments in Brazil.

Equality among Contractual Parties

The Act included new provisions in the Brazilian Civil Code reinforcing the concept of *pacta sunt servanda* (i.e., the agreement between the parties is binding) in private agreements and stipulating that parties to civil and commercial contracts will now be considered equals under most circumstances (e.g., that both parties know the terms and understand the agreements they are entering into), unless specifically provided by applicable law, such as consumer laws pursuant to which consumers will continue to be considered the weaker party for purposes of contractual arrangements. In effect, Brazilian courts are now expected to adhere to the actual contractual terms when deciding disputes, even if that results in an apparent disadvantage to the party in a seemingly weaker position. This is expected to increase legal certainty in business relations as parties can have more assurance that their contractual agreements will not be disregarded by Brazilian courts.

Single-Member Limited Liability Companies

Brazilian limited liability companies (or *sociedades limitadas*) formerly required at least two quotaholders in order to be formed and maintained, and in the case of single member LLCs (or *Empresas Individuais de Responsabilidade Limitada*, **EIRELI**), a minimum corporate capital equivalent to 100 times the federal minimum wage (approx. USD 25,000 at the current exchange rate) is required. Under the Act, *Brazilian sociedades limitadas* may now be formed and maintained with a single quotaholder (who can be an individual or a legal entity), without the need of complying with the minimum capital requirements of an EIRELI.

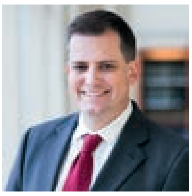
Piercing of the Corporate Veil

For courts to pierce the corporate veil, the Brazilian Civil Code requires the existence of an abuse of the legal form, which is characterized by "asset confusion" (*confusão patrimonial*) or the "misuse of the corporate purpose" (*desvio de finalidade*). Before the Act, these concepts were not defined by statute and, therefore, were subject to court interpretation. "Misuse of corporate purpose" is now limited to the use of the legal entity for purposes of harming creditors or for the commission of unlawful acts of any nature. "Asset confusion" has now been defined to be the lack of actual separation between the assets of the company and the assets of shareholders. This occurs where company assets are regularly used to satisfy the obligations of the shareholders or managers and vice-versa, there is a transfer of assets and liabilities without adequate consideration (with the exception of proportionally insignificant amounts) and under any other circumstances that demonstrate a lack of autonomy of corporate property.

Final thoughts

Additional statutory revisions are expected to be approved in the coming months in line with this new, more business-friendly legislative agenda being pushed by the current government. A major overhaul of the Brazilian tax code is also underway, and additional legislative initiatives are being proposed to further reduce the costs of doing business in Brazil. There have also been recent amendments to provisions of Brazilian labor and social security laws. The impact generated by these changes has been significant, with a substantial increase in the number of capital markets and M&A transactions in recent months and increased interest by international investors in Brazilian assets. We expect that future business-friendly legislative initiatives will continue to provide an economic environment conducive to increasing levels of foreign capital markets investments in transactions originating from Brazil.

Contacts



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About us

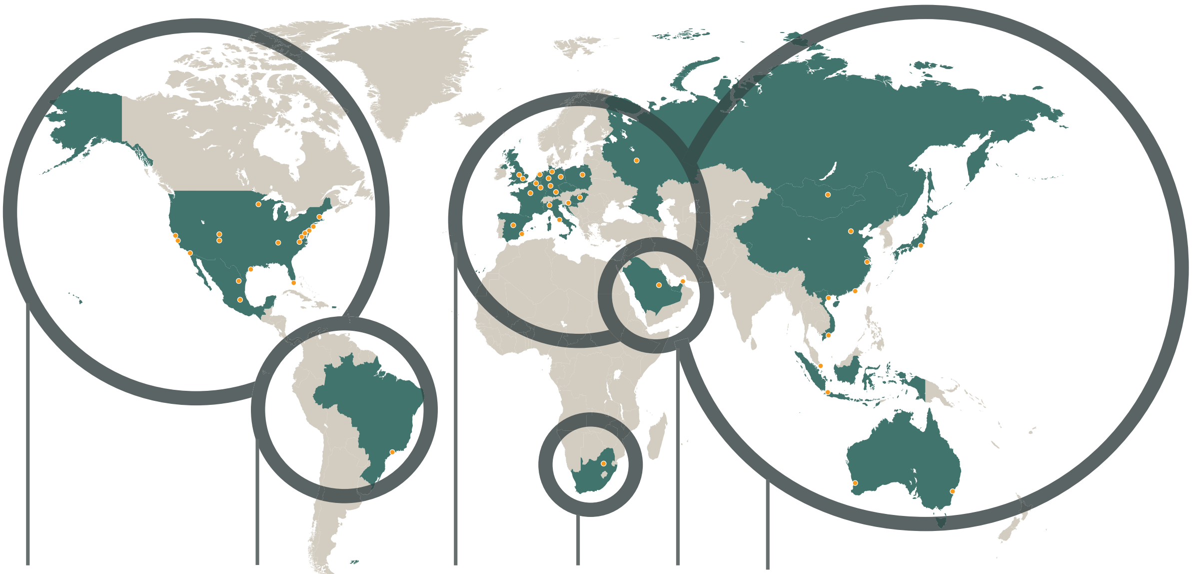
Change is happening faster than ever, and to stay ahead, you need to anticipate what's next. Legal challenges come from all directions. We understand and work together with you to solve the toughest legal issues in major industries and commercial centers around the world. Whether you're expanding into 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.



*Associated offices

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. Our clients include arrangers/underwriters, corporates, financial institutions 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, including a number of the initial simple, transparent and standardized (**STS**) deals in Europe. We help issuers and originators of securitized assets, underwriters, managers and arrangers, trustees, investors, and collateral and portfolio managers.

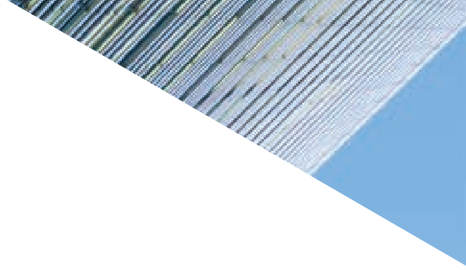
We advise on the financing of a wide range of classic and innovative asset types, both as public and private stand-alone issues, master trusts, programmes, and through conduit structures. We advise on all types of listed and/or public securitization offerings, including transactions and private placements under the EU's Prospectus Directive and under Rule 144A. We are regularly commended by independent market guides, and known for our ability to advise efficiently on flow transactions as well as on new and innovative transactions.

Our team is involved in issues regarding the changing regulatory environment relating to structured finance, Dodd-Frank legislation in the U.S. 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.

Our experience on structured finances and securitizations, combined with the resources dedicated to tax, regulatory, and U.S. securities issues within Hogan Lovells' international offices, allows us to provide clients with a competitive, knowledge-based service for all structured finance transactions.

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 (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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Munich
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Riyadh*
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