European Leveraged Finance Association

BRIEFINGS

LEGAL & REGULATORY

5 May 2021

Legal and Regulatory Updates

26/04/2021 – 30/04/2021

Key Highlights

- This Legal & Regulatory Update covers the week commencing **26/04/2021**.
- FCA consults on its proposal to exempt fixed income research from requirements of MiFID II Research Unbundling Rules.
- ESRB publishes report on prevention and management of large number of corporate insolvencies.
- European Commissions publishes its proposal to amend and update the Non-Financial Reporting Directive (NFRD).
- European Commission publishes its Banking and Finance Newsletter April 2021.
- CSSF gives update on global situation of undertakings for collective investment at end of March 2021.
- CSSF publishes its Newsletter No 243 April 2021.
- IFRS Foundation Trustees publish institutional arrangements for proposed new sustainability standards board.
- In this update, we also cover some of the most important news on leveraged finance published by the Financial Times during the week.

Financial Conduct Authority (FCA)

28 April 2021: FCA consults on its proposal to exempt fixed income research from requirements of MiFID II Research Unbundling Rules

The Financial Conduct Authority (FCA), alongside the Treasury, announced that it is considering reforms to capital markets to ensure that the domestic regulatory regime is adapted to the structures of UK markets and maintains the highest regulatory standards. The FCA published Consultation Paper (CP) 21/9, which is the first output of that work and covers changes to two areas to the conduct and organisational rules in UK MiFID: research and best execution reporting.

The FCA is proposing to create an exemption from the inducement rules for third party research that is received by a firm providing investment services or ancillary services to clients, where it is received in connection with an investment strategy primarily relating to fixed income instruments. The FCA is therefore proposing to allow fixed income research to be rebundled. The rationale is that fixed income transactions are typically not paid for by an agency commission to the broker, but instead the broker earns its revenues from the spread (the gap between the bid and ask prices of an instrument). Therefore, the proposed exemption for fixed income research does not create the same opacity risks between transaction fees and research costs that arise for equity research.

The FCA recognises that the proposed exemption for fixed income research, that would permit research to be rebundled, will not necessarily increase demand and supply. However, the FCA notes that this exempton will remove associated costs from applying the inducement rules, creating savings for producers and recipients of fixed income research. Additionally, the FCA notes that the inducement activity post-MiFID II has not been significantly affected. If research had been a material part of a broker's costs, the FCA would have expected the inducement rules to have resulted in a narrowing of spreads as a result of decoupling of research from trading spreads. However according to the FCA, industry feedback suggests this has not materialised. Therefore, exempting the rules for fixed income research should not increase inducement risks.

The ELFA strongly supports the FCA's proposal and will submit our views in the consultation. In response to a similar consultation from the EC in July last year, we noted that "[s]uch measures will contribute towards to improvement of research quality in the fixed income space, provide more fair pricing for those investors who ultimately bear the cost of such research, and alleviate some of the burden that was disproportionately extended to include fixed income instruments when considered with the original objective of these rules." As research costs are not embedded in bid-offer spreads for fixed income instruments, the research unbundling rules have effectively increased the cost of research by adding an explicit cost for fixed income research which did not exist prior to MiFID II, without the resulting reduction in spreads.

The FCA's consultation is open for feedback until the 23rd of June 2021.

26 – 30 April 2021: Speeches, Letters & Publications

During the week, the FCA released the following speeches, announcements and other publications that might be of interest to our readers:

- FCA consults on strengthening investor protections in SPACs – in CP21/10, the FCA proposes amending rules to allow an alternative approach for listed SPACs that are able to demonstrate the higher levels of investor protection that have developed in certain overseas jurisdictions

- Compliance, Culture and Evolving Regulatory Expectations – Speech by Mark Steward, Executive Director of Enforcement and Market Oversight, delivered at NYU Law School

European Securities and Markets Authority (ESMA)

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the European Securities and Markets Authority (ESMA) released the following speeches, announcements, and publications that might be of interest to our readers:

- ESMA makes new bond liquidity data available – ESMA made available new data for bonds subject to the pre- and post-trade requirements of MiFID II and MiFIR through its data register
- ESMA publishes data for the systematic internaliser calculations for equity, equity-like instruments, bonds and other non-equity instruments – ESMA published, on a voluntary basis, the total number of trades and total volume over the period October 2020-March 2021 for the purpose of the systematic internaliser (SI) calculations under MiFID II
- ESMA publishes results of the annual transparency calculations for non-equity instruments – these calculations include the liquidity assessment and the determination of the pre-and post-trade size specific to the instruments and large in scale thresholds. The transparency requirements based on the results of the annual transparency calculations for non-equity instruments shall apply from 1 June 2021 until 31 May 2022
- ESMA enters final stage in the registration of the first securitisation repositories – announced that it has reached the last stage in the assessment process of applications received from Securitisation Repositories (SRs) under the Securitisation Regulation (SECR). The obligation to report securitisation transactions to an SR under the SECR will apply as soon as one SR is formally registered. ESMA will inform market participants when the registration of the first SR(s) is completed. ESMA has 40 working days in which to finalise its assessment of the registration and, if favourable, the entity will be registered as a SR five working days after the registration decision is adopted. ESMA encourages reporting entities to take all necessary preparatory measures to comply with their reporting obligations to a SR

European Banking Authority (EBA)

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the European Banking Authority (EBA) released the following speeches, announcements, and publications that might be of interest to our readers:

- The European Banking Authority launches public consultation to enhance proportionality in liquidity reporting – the EBA launched a public consultation on its draft Implementing Technical Standards (ITS) on supervisory reporting with respect to Additional Liquidity Monitoring Metrics (ALMM). Following the mandate laid down in the revised Capital Requirements Regulation (CRR2), the EBA is proposing to introduce some proportionality considerations in ALMM reporting for small and non-complex institutions. Additional amendments to the templates are introduced with the aim of streamlining reporting requirements, filling in data gaps and further clarifying the reporting instructions

European Central Bank (ECB)

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the European Central Bank (ECB) released the following speeches, announcements, letters and publications that might be of interest to our readers:

- Euro area economic and financial developments by institutional sector: fourth quarter of 2020
- All the way to zero: guiding banks towards a carbon-neutral Europe – Keynote speech by Frank Elderson, Vice-Chair of the Supervisory Board and Member of the Executive Board of the ECB, at the conference on “The Role of Banks in Greening Our Economies”
- Maximising the user value of statistics: lessons from globalisation and the pandemic – Speech by Philip R. Lane, Member of the Executive Board of the ECB

European Systemic Risk Board (ESRB)

28 April 2021: ESRB publishes report on prevention and management of large number of corporate insolvencies

The European Systemic Risk Board (ESRB) published its report “ESRB publishes report on prevention and management of a large number of corporate insolvencies”, which reviews the risks to economic and financial stability of a potential large wave of insolvencies and the possibilities for mitigating these risks. According to the report, the threat of a wave of insolvencies looms large, unless Member States manage a smooth transition from liquidity support towards more targeted solvency support and successful corporate debt restructuring for viable firms.

The report suggests that Governments must now strengthen their lines of defence against the destabilising impact of insolvencies. The report makes the following recommendations:

- The first priority for Member States must be to create the right conditions for successful debt restructuring;
- To avoid moral hazard, it is important to ensure that the interests of public authorities and banks are aligned when debt is restructured to put companies on a sound financial footing for the recovery after COVID-19. This will require banks to bear some of the restructuring costs and downside risks;
- Efficient insolvency procedures should be used or, if unavailable, developed for companies that are found to be unviable in the post-COVID economy; and
- Finally, policies must be geared towards rebuilding the economy and fostering adaptation to structural change, rather than towards trying to preserve, or return to, the pre-pandemic economy. It will be important to ensure that capital and labour are allocated to more innovative and sustainable uses.

European Commission

26 April 2021: European Commissions publishes its proposal to amend and update the Non-Financial Reporting Directive

The European Commission published its proposal to amend and update the Non-Financial Reporting Directive (NFRD), following a public consultation from February to June 2020. This proposal consists of one Directive that would amend four existing pieces of legislation. In the first place, it would amend the Accounting Directive, revising some exiting provisions and adding certain new provisions about sustainability reporting. In addition, it would amend the Audit Directive and the Audit Regulation, to cover the audit of sustainability information. Finally, it would amend the Transparency Directive to extend the scope of the sustainability reporting requirements to companies with securities listed on regulated markets, and to clarify the supervisory regime for sustainability reporting by these companies.

In its proposal, the European Commission acknowledges the following:

- The current legal framework does not ensure that the information needs of these users are met. This is because some companies from which users want sustainability information do not report such information, while many that do report sustainability information do not report all the information that is relevant for users. When information is reported, it is often neither sufficiently reliable, nor sufficiently comparable, between companies. The information is often difficult for users to find and is rarely available in a machine-readable digital format;
- The information needs of users have increased significantly in recent years and will almost certainly continue to do so. There are several reasons for this. One is the growing awareness of investors that sustainability issues can put the financial performance of companies at risk. Another is the growing market for investment products that explicitly seek to conform to certain sustainability standards or achieve certain sustainability objectives. Yet another is regulation, including the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation. As a result of both these regulations, asset managers and financial advisers need more sustainability information from investee companies;
- There is therefore a widening gap between the sustainability information companies report and the needs of the intended users of that information. On the one hand, this means that investors are unable to take sufficient account of sustainability-related risks in their investment decisions. This in turn has the potential to create systemic risks that threaten financial stability. On the other hand, the gap means that investors cannot channel financial resources to companies with sustainable business models and activities. This in turn undermines the achievement of the objectives of the European Green Deal; and
- The current situation is also problematic for companies that have to report. The lack of precision in the current requirements, and the large number of private standards and frameworks in existence, make it difficult for companies to know exactly what information they should report. They often experience difficulties in getting the information they themselves need from suppliers, clients and investee companies. Many companies receive requests for sustainability information from stakeholders in addition to the information they report to comply with current legal requirements. All of this generates unnecessary business costs.

The objective of this proposal is therefore to:

- improve sustainability reporting at the least possible cost, in order to better harness the potential of the European single market to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and the UN Sustainable Development Goals;
- ensure that there is adequate publicly available information about the risks that sustainability issues present for companies, and the impacts of companies themselves on people and the environment. This means that companies from which users need sustainability information should report such information, and that companies should report all information users consider relevant. Reported information should be comparable, reliable and easy for users to find and make use of with digital technologies. This entails changing the status of sustainability information to make it more comparable to that of financial information;
- help reduce systemic risks to the economy. It will also improve the allocation of financial capital to companies and activities that address social, health and environmental problems. Also, it will make companies more accountable for their impacts on people and the environment, thereby building trust between them and society; and
- reduce unnecessary costs of sustainability reporting for companies, and to enable them to meet the growing demand for sustainability information in an efficient manner. It will bring clarity and certainty on what sustainability information to report, and make it easier for preparers to get the information they need for reporting purposes from their own business partners (suppliers, clients and investee companies). It should also reduce the number of demands companies receive for sustainability information in addition to the information they publish in their annual reports.

This proposal builds on and revises the sustainability reporting requirements set out in the NFRD, in order to make sustainability reporting requirements more consistent with the broader sustainable finance legal framework, including the SFDR and the Taxonomy Regulation, and to tie in with the objectives of the European Green Deal.

This proposal is open for feedback for a minimum period of 8 weeks until the 29th of June 2021. All feedback received will be summarised by the European Commission and presented to the European Parliament and Council with the aim of feeding into the legislative debate.

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the European Commission released the following speeches, announcements and publications that might be of interest to our readers:

- European Commission publishes its Banking and Finance Newsletter April 2021
- Latest business and consumer surveys: Economic Sentiment and Employment Expectations continue their strong recovery in the EU and the euro area – in April 2021, the Economic Sentiment Indicator (ESI) continued its strong recovery, gaining 9.8 (EU) / 9.4 (EA) points compared to March. At 109.7 (EU) / 110.3 (EA) points, the ESI scores markedly above its long-term average and pre-pandemic level for the first time since the outbreak of COVID-19 on the continent. Also, the Employment Expectations Indicator (EEI) saw a forceful increase (+9.9 points to 107.9 in the EU and +9.3 points to 107.1 in the euro area), which lifted the indicator both above its long-term average and pre-pandemic level
- Euro area annual inflation up to 1.6% – Euro area annual inflation is expected to be 1.6% in April 2021, up from 1.3% in March according to a flash estimate from Eurostat, the statistical office of the European Union

Commission de Surveillance du Secteur Financie (CSSF)

27 April 2021: CSSF gives update on global situation of undertakings for collective investment at end of March 2021

The Commission de Surveillance du Secteur Financier (CSSF) published an update on the global situation of undertakings for collective investment at the end of March 2021. According to the CSSF, as at 31 March 2021, the total net assets of undertakings for collective investment, comprising UCIs subject to the 2010

Law, specialised investment funds and SICARs, amounted to EUR 5,248.971 billion compared to EUR 5,090.775 billion as at 28 February 2021, i.e. an increase of 3.11% over one month. Over the last twelve months, the volume of net assets rose by 26.48%.

The Luxembourg UCI industry thus registered a positive variation amounting to EUR 158.196 billion in March. This increase represents the sum of positive net capital investments of EUR 46.758 billion (+0.92%) and of the positive development of financial markets amounting to EUR 111.438 billion (+2.19%).

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the CSSF released the following circulars, speeches, announcements and publications that might be of interest to our readers:

- CSSF publishes its Newsletter No 243 April 2021 – discover the latest publications of the CSSF and the statistics relating to the financial sector
- Jean-Pierre Faber, Director of the CSSF, speaks about the digital transformation of the CSSF and the financial sector, the importance of data and the impact of the COVID-19 crisis on the supervisory authority – Interview

International Capital Market Association (ICMA)

26 – 30 April 2021: Speeches, Letters & Other Publications

During the week, the International Capital Market Association (ICMA) released the following speeches, announcements and publications that might be of interest to our readers:

- Taxonomy takeaways for buildings: reprieve for green covered bonds? – ICMA Webinar

Other Updates

We would like to bring to our ELFA readers' attention the following regulatory updates from regulators and associations we are not currently monitoring:

26 April 2021: IFRS Foundation Trustees publish institutional arrangements for proposed new sustainability standards board

The Trustees of the IFRS Foundation published proposed amendments to the Constitution of the Foundation to accommodate the potential formation of a new International Sustainability Standards Board (ISSB) within the governance structure of the organisation. In addition, the Trustees have published a Feedback Statement that summarises feedback received to their consultation on sustainability reporting. All decisions were discussed and agreed at the 26 April 2021 Trustees meeting. The Trustees recognised and appreciated the recent statements of support for a new sustainability board from the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), and remain on track to make a final determination about a new board in advance of the November 2021 United Nations COP26 conference.

The Trustees are seeking feedback on proposed amendments to the Foundation's Constitution to accommodate the potential formation and operation of the ISSB. The amendments include revisions to the objectives of the Foundation and the institutional arrangements for the ISSB. The consultation is open for comment for 90 days and closes on 29 July 2021.

The Trustees have also published a comprehensive Feedback Statement that summarises responses to their September 2020 consultation on sustainability reporting and how the Trustees have responded to that feedback. The consultation sought feedback on demand for global standards and whether the Foundation should play a role. A total of 577 responses were submitted from organisations and individuals from around the world, with feedback indicating growing and urgent demand for global standards and broad support for the creation of a new sustainability standards board within the governance structure of the Foundation. Feedback from that consultation underpinned decisions announced by Trustees in February and March and continues to inform the Trustees' actions and decision-making.

5 May 2021

In the News

During the week, the Financial Times published the following news that might be of interest to our readers.

Financial Times

- UK regulator proposes 'quick fixes' for Mifid rules
  "The UK's financial regulator has proposed several quick fixes to rules covering investment research and reporting requirements for share trading to ensure that asset managers are not at a disadvantage to their European competitors now the country has left the EU. The Financial Conduct Authority suggested the tweaks after EU authorities last year revealed a wide-ranging series of updates to the pan-Europe market rules, known as Mifid II, which came into effect in 2018. The FCA was one of the main architects of Europe's Mifid rule book, but it has pledged that a post-Brexit UK will not be a rule taker from Brussels — a stance likely to lead to new divergences in financial regulations between Britain and Europe"
- A new model of 'trickle down sustainability'
  "As environmental, social and governance (ESG) risks rocket up the corporate agenda, a growing number of companies are recognising that sustainability cannot be achieved in a vacuum. In recent months we have seen a noticeable surge of companies grilling prospective vendors on sustainability before awarding a contract. This is a clear indication of how ESG is permeating down through the supply chain. Big companies are probably asking these questions because investors and ESG rating agencies are asking them for documentation to show they are keeping an eye on their own risk"
- Half of financial institutions fail to conduct climate analysis, CDP says
  "Half of financial institutions indicated they did not conduct any analysis of how their portfolios impact climate change, according to a report released today from CDP (formerly known as the Carbon Disclosure Project). Only about half of insurance companies disclosed a low-carbon transition plan and only half of those companies were taking action with their underwriting portfolios, CDP said. Plus, only a quarter of the companies reported their financed emissions, according to CDP. These paltry disclosures suggest financial institutions are underestimating their climate risks"
- ESG rush opens opportunities for betting against the angels
  "Over the next decade, an ungodly amount of money is going to be made out of environmental, social and governance-oriented investing. Unfortunately, much of it will probably be made by betting against the angels. The ESG phenomenon is unquestionably one of the most powerful forces in markets at the moment, with investment groups locked in a frenzied game of one-upmanship, each competing to take ESG more seriously than the next — or at least appear to do so"
- Ares raises €11bn private debt fund amid alternative lending rush
  "US investment group Ares has raised €11bn for one of the world's largest private debt funds, as lightly regulated alternative lenders step up their attempt to supplant traditional banks and bond markets in the wake of the pandemic. The fund will be Europe's largest of its type, according to data from Preqin. It will lend money directly to medium-sized companies in the region that want or need an alternative to the typically cheaper funding routes of bank loans and bond markets"

5 May 2021

Regulators and Associations Monitored

1. FCA
2. BoE
3. The Pensions Regulator
4. FRC
5. ESMA
6. EBA
7. EIOPA
8. ESRB
9. ECB
10. European Commission
11. BCBS
12. Autorité des Marchés Financiers (AMF) of France
13. CSSF
14. FINMA
15. CBI
16. ICMA
17. IOSCO
18. FSB

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