European Leveraged Finance Association

BRIEFINGS

LEGAL & REGULATORY

9 July 2021

Legal and Regulatory Updates

28/06/2021 – 02/07/2021

Key Highlights

- This Legal & Regulatory Update covers the week commencing **28/06/2021**.
- PRA publishes its Regulatory Digest June 2021.
- EBA data shows a deterioration in asset quality of the most affected sectors.
- EBA provides clarification on the implementation of the new prudential regime for investment firms.
- ESMA and EBA publish final guidance on fit and proper requirements.
- ESMA publishes first overview of national rules governing fund marketing.
- ECB and ESRB publish joint report showing uneven impacts of climate change for the EU financial sector.
- ESRB publishes its ESRB risk dashboard June 2021.
- European Commission finds regulation on settlement and central securities depositories (CSDR) achieving aims, significant changes not needed.
- AMF approves, for the first time, a bond prospectus that allows the listing of Sustainable Linked Bonds on Euronext Paris.
- CSSF publishes information on global situation of undertakings for collective investment at the end of May 2021.
- IOSCO publishes a report on issuers' sustainability-related disclosures, and elaborates on its vision and expectations for the IFRS Foundation's work towards a global baseline of investor-focussed sustainability standards to improve the global consistency, comparability and reliability of sustainability reporting.
- IOSCO consults on sustainability-related regulatory and supervisory expectations in asset management.
- FSB launches thematic peer review on corporate debt workouts and invites feedback from stakeholders.
- In this update, we also cover some of the most important news on leveraged finance published by the Financial Times during the week.

Bank of England (BoE)

28 June – 02 July 2021: Speeches, Letters & Publications

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

- PRA publishes its Regulatory Digest June 2021 – the PRA Regulatory Digest is for people working in the UK financial services industry and highlights key regulatory news and publications delivered for the month
- Consultations by the FPC and PRA on changes to the UK leverage ratio framework – the Financial Policy Committee (FPC) conducted a comprehensive review of the UK leverage ratio framework in light of revised international standards, and its ongoing commitment to review its policy approach. This review outlines the changes that the FPC proposes to make to the framework, and the Prudential Regulation Authority's (PRA) proposed approach to implementing these changes. The PRA has reviewed the leverage ratio framework concurrently, including to reflect international developments, and has coordinated closely with the FPC in relation to its review. The PRA considers that the FPC's proposals would advance the PRA's objective
- Minutes of the Working Group on Sterling Risk-Free Reference Rates May 2021 – the Working Group on Sterling Risk-Free Reference Rates, which is comprised of a diverse set of market participants, is working to catalyse a broad-based transition to SONIA by end-2021

Financial Conduct Authority (FCA)

28 June – 02 July 2021: Speeches, Letters & Publications

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

- FCA reviews finds weaknesses in some 'host' Authorised Fund Management firms' governance and operations – the FCA has called for so-called 'host' Authorised Managers (AFMs) to improve their standards following a review of firms published. The FCA found that, while some firms were operating well, others did not meet FCA standards. The FCA found weaknesses in governance structures, conflicts of interest management and operational controls. The FCA also found some firms referring to funds as if they were solely operated by delegate third-party investment managers or fund sponsors rather than themselves, and a lack of focus on controlling the risk of harm from investors exposed to inappropriate or poor value products. The review focussed on host AFMs but some of the findings are also applicable to in-house AFMs

European Banking Authority (EBA)

30 June 2021: EBA data shows a deterioration in asset quality of the most affected sectors

The European Banking Authority (EBA) published its quarterly Risk Dashboard together with the results of the spring edition of the Risk Assessment Questionnaire (RAQ). The Q1 data shows that the CET1 ratio increased slightly on a fully loaded basis. The NPL ratio improved further, except for some sectors that may have been more affected by the pandemic. Banks' profitability improved significantly.

Key highlights from the report include:

- the CET1 ratio increased again slightly in Q1 2021,
- the NPL ratio declined despite a slight rise in NPL volumes,
- looking forward, the RAQ results show that a comparatively high share of banks expects rather a deterioration in the asset quality of most portfolios,
- loans under EBA eligible moratoria declined further in Q1 2021,
- profitability improved strongly,
- the loan to deposit ratio declined further from 112.2% in Q4 to 111.0% in Q1, supported by a bigger rise in client deposits from households and NFCs than respective loans, and
- close to 60% of the banks see an increase in operational risk, which is similar to previous surveys.

01 July 2021: EBA provides clarification on the implementation of the new prudential regime for investment firms

The EBA published an Opinion to ease the implementation of the Investment Firms Regulation (IFR) and Investment Firms Directive (IFD), which entered into force on June 26. The IFR/IFD classify investment firms according to their business model and size, the latter of which is benchmarked on various threshold. For the vast majority of investment firms, sufficient clarity already exists with regards to the prudential regime, which applies to them. However, in a few cases, especially for investment firms of third country groups, the Opinion provides guidance on the actions to be taken in case of uncertainty on whether these investment firms should apply for an authorisation as a credit institution in the absence of the delegated act establishing the methodology for the calculation of the highest threshold (the EUR 30bn threshold), on which the EBA has currently opened a second public consultation.

02 July 2021: EBA publishes its final Guidelines on internal governance

The EBA published its revised Guidelines on internal governance. The update takes into account the amendments introduced by the fifth Capital Requirements Directive (CRD V) and the Investment Firms Directive (IFD) in relation to credit institutions' sound and effective governance arrangements, in particular with regard to gender diversity, money laundering, financing terrorist risk and the management of conflicts of interest, including in the context of loans and other transactions with members of the management body and their related parties. The final revised Guidelines will apply from 31 December 2021.

02 July 2021: EBA publishes its final revised Guidelines on sound remuneration policies

The EBA published its revised Guidelines on sound remuneration policies. This update takes into account the amendments introduced by the fifth Capital Requirements Directive (CRD V) in relation to institutions' sound remuneration policies and, in particular, the requirement that remuneration policies should be gender neutral. The final Guidelines also consider supervisory practices and clarify some aspects of retention bonuses and severance pays. The revised Guidelines will apply from 31 December 2021.

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- EBA consults on technical standards on risk retention requirements under the Securitisation Regulation – EBA launched a public consultation on draft Regulatory Technical Standards (RTS) specifying the requirements for originators, sponsors, original lenders and servicers related to risk retention, in line with the Securitisation Regulation. The RTS aim to clarify requirements relating to risk retention, thus reducing the risk of moral hazard and aligning interests. The RTS also provide clarity on new topics, including risk retention in traditional securitisation of non-performing exposures (NPE). The consultation runs until 30 September 2021
- EBA announces timing for publication of 2021 EU-wide stress test results – EBA announced that individual results for the banks participating in the 2021 EU-wide stress test, along with a report summarising the results in aggregate terms, will be published on Friday 30 July 2021 at 18:00 Central European Summer Time (CEST)

European Securities and Markets Authority (ESMA)

02 July 2021: ESMA and EBA publish final guidance on fit and proper requirements

The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) published their revised final joint Guidelines on the assessment of the suitability of members of the management body and key function holders. These Guidelines take into account the amendments introduced by the revised Capital Requirements Directive (CRD V) and the Investment Firms Directive (IFD), and their effect on the assessment of the suitability of members of the management body, in particular with regard to money laundering and financing terrorism risks, and gender diversity. The joint final Guidelines will apply from 31 December 2021.

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- ESMA publishes latest edition of its Newsletter
- ESMA publishes first overview of national rules governing fund marketing – in this report, ESMA provides an overview of the marketing requirements across Member States, and analyses the effects of national laws, regulations and administrative provisions governing the marketing of investment funds. The report is based on responses provided by National Competent Authorities (NCAs) to two questionnaires prepared by ESMA

European Central Bank (ECB)

01 July 2021: ECB and ESRB publish joint report showing uneven impacts of climate change for the EU financial sector

The European Central Bank (ECB) and the European Systemic Risk Board (ESRB) published a joint report that takes a closer look at how a broadened set of climate change drivers affects millions of global firms and thousands of financial firms in the European Union (EU). It maps out prospective financial stability risks and contributes by further developing the analytical basis for more targeted and effective policy action.

The report tackles measurement gaps and, building on previous work in this field, establishes a detailed topology of physical and transition risks arising from climate change across regions, sectors and firms. It also applies a scenario analysis with long-dated financial risk horizons to capture prospective financial losses resulting from the timeliness and effectiveness of climate policies and technologies.

The report's granular mapping of financial exposures to climate change drivers finds three forms of risk concentration:

- First, exposures to physical climate hazards are concentrated at the regional level. The analysis shows, for example, that river floods will be the most economically significant widespread climate risk driver in the EU over the next two decades compounded by strong vulnerability to wildfires, heat and water stress in some regions. Around 30% of the euro area banking sector's credit exposures to non-financial companies are to firms that are subject to a combination of these physical hazards.
- Second, exposures to emission-intensive firms are concentrated not only across but also within economic sectors. Exposures to highly emitting firms occupy 14% of collective euro area banking sector balance sheets. While mainly concentrated in the manufacturing, electricity, transportation and construction sectors, they also vary considerably within sectors – suggesting scope for financial market repricing as widely varying emissions intensities narrow.
- Third, exposures to climate risk drivers are concentrated in specific European financial intermediaries. Around 70% of banking system credit exposures to firms subject to high or increasing physical risk over the coming decades are concentrated in the portfolios of just 25 banks. At the same time, scope for financial market repricing associated with transition risk will be particularly large for investment funds, where more than 55% of investments are tilted toward high emitting firms and estimated alignment with the EU Taxonomy stands at only 1% of assets. While direct holdings by insurers of climate sensitive assets may be manageable, risks could be amplified by cross-holdings of investment funds of around 30%.

Long-term scenario analysis for EU banks, insurers and investment funds suggests that credit and market risk could increase as a result of a failure to effectively counteract global warming. In the projected scenario modelling what would happen in the event of an insufficiently orderly climate transition, physical risk losses – particularly for high emitting firms – would become dominant in around 15 years. This could lead to a decline in global GDP of up to 20% by the end of the century should mitigation prove to be insufficient or ineffective. As work continues on more accurately measuring and modelling climate risk, the advances described in this report should provide valuable evidence to inform the broadening climate debate in the public and private sector alike.

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- Financing a green and digital recovery – Speech by Christine Lagarde, President of the ECB, at the Brussels Economic Forum 2021
- Monetary-fiscal interactions on the way out of the crisis – Keynote speech by Fabio Panetta, Member of the Executive Board of the ECB, at the Conference of the Governors of Mediterranean Central Banks on "Central banks at the frontline of the COVID-19 crisis: weathering the storm, spurring the recovery"
- Evaluating the benefits of euro area dividend distribution recommendations on lending and provisioning – Macroprudential Bulletin

European Systemic Risk Board (ESRB)

01 July 2021: ESRB publishes its ESRB risk dashboard June 2021

The European Systemic Risk Board (ESRB) published its risk dashboard, June 2021. The ESRB risk dashboard is a set of quantitative and qualitative indicators of systemic risk in the EU financial system. It is published quarterly, one week after its adoption by the General Board, and is accompanied by an overview note that explains the recent development of the indicators, and two annexes that explain the methodology and describe the indicators.

European Commission

01 July 2021: European Commission finds regulation on settlement and central securities depositories (CSDR) achieving aims, significant changes not needed

In a published report, the European Commission concluded that, in broad terms, CSDR is achieving its original objectives to enhance the efficiency of settlement in the EU and the soundness of Central Securities Depositories ('CSDs'). For most areas, significant changes to CSDR would be premature considering the relatively recent application of requirements. Nevertheless, concerns on the implementation of specific rules have been raised. These concerns include on the cross-border provision of services, access to commercial bank money, settlement discipline or the framework for third-country CSDs.

- The report identifies areas where further action may be required to achieve CSDR's objectives in a more proportionate, effective and efficient manner. In light of the important issues raised, and as also announced in the 2021 Commission work programme and in the new capital markets union action plan, the Commission is considering presenting a legislative proposal to amend CSDR, subject to an impact assessment that will examine the most appropriate solutions in more depth. The proposal will aim at ensuring an effective post-trading infrastructure, enhancing competition among CSDs, strengthening cross-border investment, thereby contributing to the development of a genuine single market for capital in the EU.

Autorité des marchés financiers (AMF)

30 June 2021: AMF approves, for the first time, a bond prospectus that allows the listing of Sustainable Linked Bonds on Euronext Paris

The Autorité des marchés financiers (AMF) approved a prospectus allowing listing of French Sustainable Linked Bonds (SLB) on Euronext Paris. Unlike green bonds, where the funds raised are used to finance "green assets", coupon payments for SLBs increase automatically at a predefined date if the issuer has failed to meet the sustainability targets set at the time of issue. These quantified sustainability targets are set through key performance indicators (KPIs) defined in the prospectus. SLB issues have developed discreetly in recent months in Europe, mainly through private placements without publication of a prospectus. The AMF expects these issues to become more widespread and to expand to include bond transactions admitted to trading on regulated markets.

As part of its review of the relevant prospectuses, the AMF will assist issuers of SLBs, which may be subject to French law. In particular, in their prospectus subject to French law, issuers may provide for methodological changes to the calculation of KPIs during the life of the SLB. These changes may be made either in prior consultation with the holders where required or unilaterally where such changes, relating to very specific points and within certain limits, are determined in the prospectus and do not have a material adverse effect on the interests of the holders.

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- The AMF publishes a study on the development of the SPAC market and its challenges

Commission de Surveillance du Secteur Financier (CSSF)

28 June – 02 July 2021: Speeches, Letters & Other Publications

During the week, the Commission de Surveillance du Secteur Financier (CSSF) released the following speeches, announcements, letters and publications that might be of interest to our readers:

- CSSF publishes information on global situation of undertakings for collective investment at the end of May 2021 – as at 31 May 2021, the total net assets of undertakings for collective investment, comprising UCIs subject to the 2010 Law, specialized investment funds and SICARs, amounted to EUR 5,332.392 billion compared to EUR 5,293.816 billion as at 30 April 2021, i.e. an increase of 0.73% over one month. Over the last twelve months, the volume of net assets rose by 18.94%. The Luxembourg UCI industry thus registered a positive variation amounting to EUR 38.576 billion in May. This increase represents the sum of positive net capital investments of EUR 23.240 billion (+0.44%) and of the positive development of financial markets amounting to EUR 15.336 billion (+0.29%).

Central Bank of Ireland (CBI)

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- "Higher debt can limit room for manoeuvre in future downturns" – Speech by Deputy Governor Sharon Donnery
- The Central Bank publishes the third Quarterly Bulletin of 2021

International Capital Market Association (ICMA)

28 June – 02 July 2021: Speeches, Letters & Other Publications

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

- Podcast: Monthly Market update: ICMA Asset Management & Investors Council – Bob Parker, Chair of ICMA's Asset Management and Investors Council, reviews the market events of the past weeks, including the ongoing rise of inflation, Central Banks monetary policies as well as negative real bond yields

International Organization of Securities Commissions (IOSCO)

28 June 2021: IOSCO publishes a report on issuers' sustainability-related disclosures, and elaborates on its vision and expectations for the IFRS Foundation's work towards a global baseline of investor-focussed sustainability standards to improve the global consistency, comparability and reliability of sustainability reporting

The Board of the International Organization of Securities Commissions (IOSCO) published a report on issuers' sustainability-related disclosures. The report, developed by IOSCO's Sustainable Finance Taskforce (STF), reiterates the urgent need to improve the consistency, comparability and reliability of sustainability reporting for investors. Over the year since the STF was established, global momentum has been building in both public and private sector initiatives on sustainability-related disclosures. IOSCO´s work aims to support investors' evolving informational needs and the ability of markets to price sustainability-related risks and opportunities and support capital allocation.

An important aspect of IOSCO's work has been engagement with the International Financial Reporting Standards (IFRS) Foundation's efforts to develop a common set of global sustainability standards to help meet investor needs and to set a sound baseline for jurisdictions to consider when setting or implementing their sustainability-related disclosure requirements. The IFRS is seeking to establish an International Sustainability Standards Board (ISSB) to sit alongside the International Accounting Standards Board (IASB), and the Report elaborates on IOSCO's vision and expectations for an ISSB. IOSCO plans to consider potential endorsement of future standards issued by the ISSB to use for cross-border – and potentially also domestic – purposes to guide issuers' sustainability related reporting in their jurisdictions. Potential endorsement will require that IOSCO's expectations regarding strong governance and decision-useful content are satisfied.

IOSCO recognises that individual jurisdictions have different domestic arrangements for adopting, applying or otherwise availing of international standards. IOSCO emphasised that it will be important for individual jurisdictions to consider how the common global baseline of standards might be adopted, applied or otherwise utilized within the context of these arrangements and wider legal and regulatory frameworks, in a way that promotes consistent, comparable and reliable sustainability disclosures across jurisdictions. It will also be important for any international standards to be applied in a flexible and scalable way that recognises the different needs, profiles and resources of different jurisdictions and issuer communities.

30 June 2021: IOSCO consults on sustainability-related regulatory and supervisory expectations in asset management

IOSCO announced that it is requesting feedback on proposed recommendations about sustainability-related regulatory and supervisory expectations in asset management. The IOSCO Consultation Report on Recommendations for Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (Consultation Report) focuses on investor protection issues and proposes that securities regulators consider setting regulatory and supervisory expectations for asset managers regarding sustainability-related risks and opportunities.

The recommendations cover five areas:

- asset manager practices, policies, procedures and disclosure
- product disclosure
- supervision and enforcement
- terminology
- financial and investor education

The recommendations aim to address various challenges, such as existing gaps in skills and expertise and the risk of fragmentation caused by divergent regulatory approaches. These challenges may further contribute to a lack of comparability for sustainability-related products, creating difficulties for investors' monitoring and decision-making, and therefore facilitating greenwashing.

The Consultation Report outlines the types of greenwashing at the asset manager and product levels, describes the different regulatory approaches taken by securities regulators to address sustainability-related risks and opportunities and provides an overview of the financial and investor education initiatives conducted by regulators. The Consultation Report discusses asset managers' sustainability-related practices and firm level disclosures, which are broadly categorised into the following areas, consistent with the Task Force on Climate-related Financial Disclosures Recommendations (TCFD Recommendations): governance, strategy, risk management, and metrics and targets. The Consultation Report also highlights a clear need to address the challenges associated with the lack of reliability and comparability of data at the corporate level and the ESG data and ratings provided by third-party providers. The recently published Report on Sustainability related Issuer Disclosures addresses data gaps at the corporate level, while a separate IOSCO report, to be published in July, will cover the proliferation of data and ESG ratings providers.

Financial Stability Board (FSB)

28 June 2021: FSB launches thematic peer review on corporate debt workouts and invites feedback from stakeholders

The Financial Stability Board (FSB) announced that it is seeking feedback from stakeholders as part of its thematic peer review on corporate debt workouts. The objective of the review is to support COVID-19 response efforts by examining FSB member jurisdictions' practices, experiences and lessons from out of court debt workouts (OCWs), and the implications for financial stability. The peer review will take stock of existing and planned OCW frameworks in FSB jurisdictions. It will examine the experience of particular mechanisms that have been or are being used to address corporate stress, including the role of financial sector authorities. The review will also seek to identify good practices and examples of how well OCW frameworks have worked in terms of preserving value for viable companies and how useful their debt restructurings are for resolving non-performing loans and dealing with a large number of distressed corporates.

The Summary Terms of Reference provide more details on the objectives, scope and process for this review. The FSB has circulated a questionnaire to its member jurisdictions to collect information in this area. In addition, as part of this peer review, the FSB invites feedback from financial institutions, corporates, insolvency practitioners and other stakeholders on out of court corporate debt workouts. This could include comments on:

- the types of OCW frameworks (e.g. informal workouts, enhanced workouts and hybrid workouts) most often used in your jurisdiction and why;
- features of OCW frameworks that may be particularly helpful to minimise the economic and financial system damage caused by corporate defaults due to COVID-19;
- the appropriate role of financial sector authorities in facilitating debt restructuring, including to incentivise the participation of various stakeholders in an OCW; and
- experiences and challenges in the use of OCWs, including to manage the volume of non-performing loans in the financial system. Feedback should be sent to the FSB by 9 August 2021.

9 July 2021

In the News

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

Financial Times

- ECB to crack down on dangerous risks in banks' leveraged lending
  "Banks are too complacent about the excessive risks building up in leveraged loan and equity derivative markets and can expect higher capital requirements as a result, the European Central Bank's head of supervision has warned. Andrea Enria said on Friday that he was worried about market complacency and excessive risk-taking by banks, adding that there were warning signs of increasing leverage, financial complexity and opacity creating the potential for a dangerous combination of risk factors. ECB officials said the speech signalled that the supervisor had lost patience with several larger eurozone lenders, such as Deutsche Bank, which have been rebuffing its calls for them to rein in riskier lending"
- Climate change should already be in the company accounts
  "The world of climate reporting gives the financial crisis a run for its money on acronyms. Coming together in the effort to standardise how the world should define and track corporate sustainability is a collection of interested parties including the CDSB, the TCFD, the IIRC and the SASB (the latter two of which are now known as the VRF). Others such as the GRI and the CDP are also involved. You don't really need to know what all these stand for, or what they've done to date. They all care about having consistent reporting concerning environmental, social and governance (ESG) issues and are working with the IFRS Foundation to set up an International Sustainability Standards Board, or the ISSB. That will be the sustainability standards setter alongside its accounting equivalent, the IASB"
- The rise of ESG-linked pay packages
  "ESG issues have taken corporate boardrooms by storm, and companies are increasingly considering tying ESG metrics to executive bonus plans. UK and European companies have led the pack on this for years. For example, since 2016, AXA has tied a portion of chief executive Thomas Buberl's pay to the company's rank in the Dow Jones Sustainability Index. Meanwhile, just 22 per cent of US companies included ESG metrics in their 2020 incentive pay plans. That's compared to 89 per cent for UK and EU companies, according to a survey published this month from Pay Governance, a consultancy. But the US is likely to close the gap within the next two to three years, the report said. Momentum could follow the path for say-on-pay votes, which started in Europe before becoming mandatory in the US in 2011. Mastercard and KBR are among the US companies that have said they will start pegging some pay to ESG this year"
- Wellcome pledges £29bn investment fund will be carbon zero by 2050
  "Wellcome, the £29bn endowment foundation, has pledged that its vast portfolio of investments in shares, hedge funds, private equity and property will become carbon net zero before 2050"
- Drax executive quits UK climate committee after conflict questions raised
  "The head of climate change at power group Drax has stepped down from a position on the UK's climate advisory committee, months after a potential conflict of interest was flagged by a member of the House of Lords"
- Business schools push to help more women into finance
  "To increase the low number of women in senior finance roles, some schools are on a push to help dismantle the barriers to their progression. They are trying a range of approaches — ranging from new curriculum design to on-campus and alumni networks"

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**

Important Information:

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