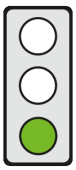
THE CAPITAL MARKETS RECOVERY PACKAGE

On 24 July 2020, the EU Commission proposed the Capital Markets Recovery Package (CMRP) as a reaction to the severe economic shock caused by the COVID-19 pandemic. According to the Commission, this shock urgently calls for some regulatory "quick fix" relief for capital markets participants to support the recovery of Europe's economies.
This publication analyses the whole CMRP, which consists of targeted amendments to
(1) the Markets in Financial Instruments Directive (MiFID II),
(2) the Prospectus Regulation and
(3) the Securitisation Regulation and the Capital Requirements Regulation.

MIFID II CORONA QUICK FIX

Objective of the Directive: The Commission wants to remove administrative burdens in MiFID II rules to support Europe's recovery from the severe economic consequences of the COVID-19 pandemic.

Affected parties: Investors, investment firms, trading venues and other financial market participants.



Pro: (1) The abolition of several information requirements lowers the administrative burden for investments without significantly impairing the protection of investors.

(2) The abolition of the position limits regime except for agricultural and significant or critical commodity derivatives makes the regime more effective.

(3) The extension of the hedging exemption eliminates structural disadvantages and does not endanger the stability of the financial system.

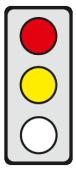
Contra: –

Proposal: The research unbundling rule should be completely repealed. It is sufficient to require investment firms to disclose potential conflicts of interests to their clients and the costs for each service.

PROSPECTUS CORONA QUICK FIX

Objective of the Regulation: The Commission wants to lower the administrative burden for issuers and financial intermediaries resulting from the Prospectus Regulation.

Affected parties: Issuers of securities, investors, financial intermediaries, regulated markets, SME growth markets.



Pro: (1) The new rules on supplements for prospectuses in case of inaccuracies usefully lower the burden for financial intermediaries while ensuring investor protection.

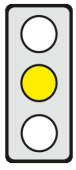
Contra: (1) The COVID-19 pandemic cannot serve as a reason for temporary relaxations of prospectus duties: Information asymmetries that exist between issuers and investors do not vanish during such a pandemic.

(2) Investor protection will suffer from the proposed elevation of the threshold for non-equity issuances of banks to 150 million euros. Thresholds are always arbitrary and give rise to distortions of competition as banks that issue below such threshold profit from lower issuance costs.

SECURITISATIONS CORONA QUICK FIX

Objective of the Regulations: Changes to the securitisation rules aim to support the lending capacity of banks in the COVID-19 crisis.

Affected parties: Banks, investors in securitisations.



Pro: (1) The proposed exceptions for NPE-securitisations reflect their specific nature. The proposed easing of prudential rules is acceptable because it is limited to senior tranches of already heavily discounted NPE-exposures.

(2) Even though experience with true-sale securitisations is very limited, preferential treatment for on-balance-sheet synthetic securitisations is acceptable. The minimum requirements regarding the credit protection agreement and the limitation to senior positions that meet additional risk concentration criteria are adequate conditions for such treatment as they significantly reduce risks to banks.

Contra: (1) As the entry into force of rules on the maximum leverage ratios of banks has been delayed because of the COVID-19 crisis, it will be important for supervisors to monitor the impact of the proposed prudential easing on bank leverage.

(2) The proposals risk intensifying the bank–state nexus which may increase systemic risks.

Centrum für Europäische Politik
FREIBURG | BERLIN

EU-Directive

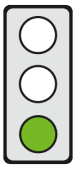
MIFID II CORONA QUICK FIX

cep**PolicyBrief** No. 2020-9

KEY ISSUES

Objective of the Directive: The Commission wants to remove administrative burdens in MiFID II rules to support Europe's recovery from the severe economic consequences of the COVID-19 pandemic.

Affected parties: Investors, investment firms, trading venues and other financial market participants.



Pro: (1) The abolition of several information requirements lowers the administrative burden for investments without significantly impairing the protection of investors.

(2) The abolition of the position limits regime except for agricultural and significant or critical commodity derivatives makes the regime more effective.

(3) The extension of the hedging exemption eliminates structural disadvantages and does not endanger the stability of the financial system.

Contra: –

Proposal: The research unbundling rule should be completely repealed. It is sufficient to require investment firms to disclose potential conflicts of interests to their clients and the costs for each service.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2020) 280 of 24 July 2020 for a **Directive** of the European Parliament and the Council amending Directive 2014/65/EU **[MiFID II] as regards information requirements, product governance and position limits to help the recovery from the COVID-19 pandemic** and
Commission Delegated Directive (EU) …/… amending Delegated Directive (EU) 2017/593 **as regards the regime for research on small and mid-cap issuers and on fixed-income instruments** to help the recovery from the COVID-19 pandemic

If not mentioned otherwise, page and article numbers refer to the Commission proposal.

Brief Summary

- **Context and objectives**
  - The Markets in Financial Instruments Directive [MiFID II, 2014/65/EU, see cep**PolicyBrief** 2012-17] establishes the EU framework for investment services and trading venues.
  - The proposed Directive amending MiFID II and the proposed amendment to the Delegated Directive contain amendments to the applicable [p. 1]
    - information requirements for investment firms, especially vis-à-vis qualifying clients,
    - requirements to separate costs on investment research and trade execution costs ("research unbundling rule"),
    - requirements on the trading of derivatives.
  - The amendments shall reduce the administrative burden for investment firms and foster the nascent derivatives markets, especially with respect to energy derivatives [p. 1].
  - The proposal is part of an EU Capital Markets Recovery Package. The package also includes amendments to
    - the Prospectus Regulation [(EU) 2017/1129, see cep**PolicyBrief** 2016-16] creating a new short form „EU Recovery Prospectus" to facilitate the raising of capital in public markets [see cep**PolicyBrief** 2020-10];
    - the Securitisation Regulation [(EU) 2017/2402, see cep**PolicyBrief** 2016-04] and the Regulation on prudential requirements for banks concerning securitisations [(EU) No 575/2013] entailing measures to facilitate the securitisation of loans [see cep**PolicyBrief** 2020-11].
- **Client categorisation in MiFID II**
  MiFID II applies to qualifying and retail clients [SWD(2020) 120, p. 12; Art. 4 No. 11 MiFID II].
  - "Qualifying clients" are
    - eligible counterparties, i.a. financial institutions, national governments and central banks and

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- professional clients, i.e. clients qualifying as eligible counterparties as well as i.a. large undertakings.

– "Retail clients" are all clients not qualifying as professional clients.

► **Information requirements**

Default option for client information

– MiFID II requires investment firms to provide information to their clients in a "durable medium", e.g. paper, e-mail, CD-ROM [Art. 4 (1) (62) MiFID II]. The default option for such information provision is on paper, except if the provision in another medium is "appropriate" with respect to the business conducted, and clients specifically opt-in for another medium [Art. 3 (1) Delegated Regulation (EU) 2017/565].

– In future, "electronic format", instead of paper, will be the default option. Retail clients may, however, opt-in for receiving the information on paper and free of charge. [Art. 1 (2), Art. 1 (4)]

Requirement to provide information on costs and charges

– MiFID II requires investment firms to provide information on costs and charges – e.g. the cost of investment advice – to their clients [Art. 24 (4) MiFID II]. Information provision may, subject to certain conditions, be less comprehensive vis-à-vis qualifying clients [Art. 50 (1) Delegated Regulation (EU) 2017/565].

– In future, the information requirements on costs and charges will no longer apply to qualifying clients, except with respect to investment advice and portfolio management services [Art. 1 (7) and Art. 1 (8)].

– MiFID II requires investment firms to provide information on costs and charges "in good time" before the provision of investment services (ex ante) [Art. 24 (4) MiFID II].

– In future, investment firms can, if trading is pursued via distance communication means (e.g. by phone), provide such information also "without undue delay" after the transaction (ex post). However, the client has to agree to the delay, and must be given the option to delay the transaction until receiving the information. [Art. 1 (4)]

Cost-benefit analysis in case of switching

– MiFID II requires investments firms to undertake an assessment of the suitability for their retail and professional clients when they provide investment advice or portfolio management services; i.a. assess whether their clients have sufficient knowledge in a specific investment field. In case such services involve the switching of financial instruments, investment firms must show that the benefits of such switching outweigh the costs. [Art. 25 (2) MiFID II; Art. 54 (11) Delegated Regulation (EU) 2017/565]

– In future, such cost-benefit analysis in case of switching will only be required vis-à-vis retail clients. However, professional clients may opt-in to still receive the analysis. [Art. 1 (5) and (7)]

Ex-post service and best execution reports

– MiFID II requires investment firms to provide ex-post reports to their clients on the services they received, i.a. in the case of a 10% portfolio loss [Art. 25 (6) MiFID II; Art. 59-63 Delegated Regulation (EU) 2017/565].

– In future, investment firms will no longer have to provide such reports to qualifying clients. However, professional clients may opt-in to still receive the reports. [Art. 1 (7)]

– MiFID II requires trading and execution venues to periodically publish reports on the quality of execution of transactions on their venue ("best execution reports") [Art. 27 (3) MiFID II; Delegated Regulation (EU) 2017/575].

– In the next two years, trading and execution venues will no longer have to publish such reports [Art. 1 (6)].

Product governance requirements for corporate bonds

– MiFID II requires investment firms to fulfil product governance requirements, i.e. rules that ensure that financial instruments fit the identified target markets of clients. They apply to all financial instruments. [Art. 24 (2) and Art. 16 (3) MiFID II]

– In future, the product governance requirements will no longer apply to corporate bonds with "make-whole clauses" [Art. 1 (3) and (4)].

– Make-whole clauses [Art. 1 (2)]
  - allow issuers to call bonds before maturity and, in this case,
  - protect the investors by forcing the issuers to return the principal amount of the bonds and the net present value of the coupons.

► **Unbundling of research costs and execution costs ("research unbundling rule")**

– MiFID II requires investment firms to unbundle research costs from costs for the execution of orders ("research unbundling rule"). If they want to use research offered by third parties, they have to pay for it [Art. 24 (13) MiFID II; Art. 13 Delegated Directive (EU) 2017/593]
  - out of their own resources, or
  - from a separate research payment account funded by a research charge paid by their investing clients.

– In future, investment firms will be able to opt-out from these requirements, if the research is provided on [Art. 1, Delegated Directive (EU) …/… amending Delegated Directive (EU) 2017/593]
  - issuers with a market capitalisation of less than 1 billion euros in the last 12 months, or
  - fixed income instruments.

– In case investment firms make use of said opt-out, they will be able to pay for research and execution services jointly. However, investment firms and research providers must agree on the height of the payments attributable

to research. Investment firms must inform their clients about the joint payment. [Art. 1, Delegated Directive (EU) …/… amending Delegated Directive (EU) 2017/593]

- **Requirements for the trading of derivatives**

  Position limits for commodity derivatives

  – MiFID II enables position limits on the size of the net position an individual actor may hold in commodity derivatives that are traded on trading venues or in equivalent over the counter contracts [Art. 57 (1) MiFID II].

  – In future, position limits will apply, instead of to commodity derivatives in general, only to agricultural commodity derivatives and critical or significant commodity derivatives [Art. 1 (9)]:
    - The European Securities and Markets Authority (ESMA) must specify those derivatives in regulatory technical standards (RTS) [Art. 1 (9)].
    - When specifying critical or significant commodity derivatives, ESMA has to consider the number of market participants, the underlying commodity and the size of open interest [Art. 1 (9)].

  No position limits for derivative positions that reduce risks ("hedging exemption")

  – MiFID II specifies that position limits do not apply to derivative positions held by, or on behalf of, non-financial entities that reduce risks relating to their commercial activities ("hedging exemption") [Art. 57 (1) MiFID II].

  – In future, the non-application of position limits for derivatives held by, or on behalf of, non-financial entities that reduce risks relating to their commercial activities will be extended to derivatives held by, or on behalf of, financial entities that are part of a non-financial group and reduce risks of commercial activities of the non-financial entities of the group [Art. 1 (9)].

  Ancillary activity test

  – MiFID II does not require market actors to be authorised as investment firms, when [Art. 2 (1) (j) MiFID II]
    - they trade professionally in commodity derivatives or in emission allowances or derivatives of these, and
    - this trade is ancillary to their main business, considered at a group level.

  – Market actors must annually notify their competent authority that they make use of the exemption [Art. 2 (1) (j) MiFID II]. A regulatory technical standard sets out, based on two quantitative tests, the criteria for when a trading activity is considered ancillary [Art. 2 (4) MiFID II; Delegated Regulation (EU) 2017/592].

  – In future, market actors will no longer be required to notify that they make use of the exemption. Furthermore, ancillarity will be determined only qualitatively. The quantitative tests will no longer apply. [Art. 1 (1)]

Statement on Subsidiarity by the Commission

According to the Commission, financial markets are cross-border in nature. Thus, the rules for market actors need to be common across borders as well. National measures would lead to market fragmentation, regulatory arbitrage and competition distortions.

Legislative Procedure

24.07.2020 Adoption by the Commission
Open Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: Markus Ferber (EPP)
Federal Germany Ministries:	Finance
Committees of the German Bundestag:	Finance
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 53 (1) TFEU (Freedom of Establishment)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic impact assessment

The proposed **measures to lift a number of information requirements** are to be welcomed entirely as they **lower the administrative burden for investments without significantly impairing the protection of investors**:
First, providing information only in electronic format saves costs, lowers environmental damage and is appropriate in an increasingly digitalised economy.

Second, while information on costs and charges is crucial to make informed investment decisions, qualifying clients are usually capable of negotiating contract conditions individually with financial services providers. Thus, they are – as opposed to retail clients – regularly not dependant on being protected by standardised costs and charges information requirements. In this spirit, the Commission should consider extending the exemption also to investment advice and portfolio management services or at least provide for opt-out options for qualifying investors.
Third, giving clients of investment firms the option to receive costs and charges information also ex post in case of trading via distance communication means ensures that orders can be processed faster, which also lowers the risk for adverse price changes between information provision and order execution. Applying the option to any client type ensures equal treatment in trading. And, as clients still have the right for ex-ante provision of information, investor protection is appropriately warranted.
Fourth, lifting the product governance provisions with respect to corporate bonds with make-whole clauses reduces costs for their issuers without substantial detriment to investor protection. Such bonds are regularly simply structured, do not change their pattern and are easily understandable also for retail clients. In contrast to the current (now planned to be changed) classification within the PRIIP Regulation [(EU) No 1286/2014, see cep**PolicyBrief** 2013-02], such bonds are often non-complex. Furthermore, important safeguards in MIFID II – the suitability and the appropriateness tests – will remain in place, thus ensuring investor protection. As the proposed lifting of requirements now solely affects corporate bonds with make-whole clauses, the Commission should, in due time, thoroughly assess again, which products should be deemed complex or non-complex, in order to avoid distortions of competition among financial products and their issuers.
The "research unbundling rule" should be repealed completely. The alleviations envisaged for issuers with a market capitalisation of less than 1 billion euros in the last 12 months and for fixed income instruments should be extended to all issuers and instruments. **It is sufficient to require investment firms to disclose potential conflicts of interests to their clients** inherent to such bundling **and the costs for each service.** As a result, clients can decide independently which payment method they prefer. What is more, repealing the unbundling rule only for small issuers and fixed income instruments – that indisputably have suffered most from the unbundling rule in recent years as research on them declined – risks creating new distortions of competition among issuers and financial instruments.
MiFID II established position limits on the trading of commodity derivatives in order to tackle market abuse and to contribute to a more efficient pricing of the commodities underlying the derivatives, e.g. oil, metals, wheat. However, these targets could not be achieved, especially in markets for less significant and non-critical commodity derivatives. Instead, said limits established a barrier for some derivative markets to grow, in particular, in the energy sector, which also inhibited their liquidity. **The abolition of the position limits regime except for agricultural and significant or critical commodity derivatives makes the regime more effective.**
The possibility for non-financial entities to apply for a hedging exemption has been and still is appropriate insofar as the derivatives trading of these entities poses no systemic threats to the wider financial system. It, however, leads to a discrimination of non-financial entities part of a group that established financial entities for the sole purpose of hedging risks with respect to their commercial activities. **The** envisaged **extension of the hedging exemption** to those financial entities rightly **eliminates** these **structural disadvantages and**, as it is limited to the hedging of the activities of non-financial group**, does not endangers the stability of the financial system.**

Legal assessment

Legislative Competence of the EU

The Directive is rightly based on Art. 53 (1) TFEU concerning the taking-up and pursuit of self-employed activities, the same legal basis as MiFID II, as it harmonises national provisions regarding investment activities.

Subsidiarity and Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

Unproblematic.

Conclusion

The measures to lift a number of information requirements lower the administrative burden for investments without significantly impairing the protection of investors. The research unbundling rule should be completely repealed. It is sufficient to require investment firms to disclose potential conflicts of interests to their clients and the costs for each service. Limiting the position limits regime to agricultural and significant or critical commodity derivatives makes the regime more effective. The extension of the hedging exemption eliminates structural disadvantages and does not endangers the stability of the financial system.

Centrum für Europäische Politik
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EU-Regulation

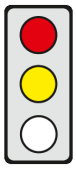
PROSPECTUS CORONA QUICK FIX

cep**PolicyBrief** No. 2020-10

KEY ISSUES

Objective of the Regulation: The Commission wants to lower the administrative burden for issuers and financial intermediaries resulting from the Prospectus Regulation.

Affected parties: Issuers of securities, investors, financial intermediaries, regulated markets, SME growth markets.



Pro: (1) The new rules on supplements for prospectuses in case of inaccuracies usefully lower the burden for financial intermediaries while ensuring investor protection.

Contra: (1) The COVID-19 pandemic cannot serve as a reason for temporary relaxations of prospectus duties: Information asymmetries that exist between issuers and investors do not vanish during such a pandemic.

(2) Investor protection will suffer from the proposed elevation of the threshold for non-equity issuances of banks to 150 million euros. Thresholds are always arbitrary and give rise to distortions of competition as banks that issue below such threshold profit from lower issuance costs.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2020) 281 of 24 July 2020 for a **Regulation** of the European Parliament and of the Council amending Regulation (EU) 2017/1129 as regards the **EU Recovery prospectus and targeted adjustments for financial intermediaries to help the recovery from the COVID-19 pandemic**.

If not mentioned otherwise, page and article numbers refer to the Commission proposal.

Brief Summary

- **Context**
  - "Prospectuses" are documents which issuers of securities regularly have to publish when the securities are offered to the public or admitted to trading. They offer investors information as a basis for their investment decision.
  - The Prospectus Regulation [(EU) 2017/1129, see cep**PolicyBrief** 2016-16] lays down the requirements for the "drawing up, approval and distribution" of prospectuses [Recital 2].
  - As a reaction to the COVID-19 pandemic, governments in the EU provided credit to distressed companies in the form of guaranteed loans. Increasing debt levels, however, can impair the solvency of companies in the long run. What is more, the pandemic may impair banks' ability to provide financing to the real economy. Thus, the Commission, wants to amend the Prospectus Regulation to
    - make it easier and cheaper for issuers to raise capital to restore their debt-to-equity ratio by introducing a less comprehensive and temporary "EU Recovery prospectus" [p. 5 SWD(2020) 120], and
    - alleviate the duty for banks to publish a prospectus for non-equity issuances.
  - The proposal is part of an EU Capital Markets Recovery Package. The package also includes amendments to
    - the Markets in Financial Instruments Directive [MiFID II, 2014/65/EU, see cep**PolicyBrief** 2012-17] to alleviate information requirements for investment firms and help nascent energy derivative markets [see cep**PolicyBrief** 2020-09];
    - the Securitisation Regulation [(EU) 2017/2402, see cep**PolicyBrief** 2016-04] and the Regulation on prudential requirements for banks concerning securitisations [(EU) No 575/2013] entailing measures to facilitate the securitisation of loans [see cep**PolicyBrief** 2020-11**]**.

- **EU Recovery prospectus**
  - The existing Prospectus Regulation provides for simplified prospectuses for secondary issuances of securities. Issuers may use these when they issue [Art. 14 Prospectus Regulation]
    - securities that are fungible (i.e. interchangeable) with securities issued by them that have been continuously admitted to trading on a regulated market (traditional exchange) or SME growth market (trading venue specialised on small and medium-sized entities (SMEs) during at least the past 18 months,

- non-equity securities (e.g. bonds) if they have already issued equity securities that have been continuously admitted to trading on a regulated market or SME growth market during at least the past 18 months.

– An "EU Recovery prospectus", a new simplified prospectus regime for secondary issuances of equity shares, is created [Art. 1 (5)]. It applies for 18 months from the date of application of the Regulation [Art. 1 (9)].
– The EU Recovery prospectus applies to issuers that issue new equity shares that are fungible with previously issued shares and where the existing shares of the issuer have been continuously [Art. 1 (5)]
  - admitted to trading on a regulated market during at least the past 18 months,
  - traded on an SME growth market during at least the past 18 months and a prospectus for these shares has been published.
– The EU Recovery prospectus has a maximum length of 30 pages. Information that is already available in the market can be incorporated by reference without being taken into account as regards the 30 pages limit. [Art. 1 (5)]
– The EU Recovery prospectus shall only contain the "relevant reduced information", notably [Art. 1 (5) Annex Va]
  - Information on the prospects of the issuer and on significant changes to its financial position since the last financial year, and
  - essential information on the shares, the reasons of the issuance and the impact on the issuer's capital structure and the use of proceeds.
– The EU Recovery prospectus shall be written in an "easily analysable, concise and comprehensible form" [Art. 1 (5)].
– The competent authority approving the prospectus shall, in particular, consider whether the issuer has already disclosed information under the [Art. 1 (5)]
  - Transparency Directive [2004/109/EC], e.g. financial reports of the issuer, and
  - Market Abuse Regulation [(EU) No 596/2014], e.g. inside information about the issuer.
– The EU Recovery prospectus shall include a summary with a maximum length of two pages [Art. 1 (4)].
– The issuer must submit the EU Recovery prospectus to its competent authority for approval. He has to inform the authority about his intention to do so five days prior to the submission. The authority must decide upon the approval of the prospectus within five working days. [Art. 1 (6)]

► **Non-equity securities issued by banks**
– The Prospectus Regulation stipulates that banks issuing non-equity securities – e.g. bonds – to the public are not required to publish a prospectus, if, in particular, [Art. 1 (4) (j) Prospectus Regulation]
  - the securities are issued in a continuous or repeated manner, and
  - the total consideration of the offer is less than 75 million euro over a period of 12 months.
– For non-equity securities issued by banks, the threshold triggering a duty to publish a prospectus is raised from 75 million euro to 150 million euro. This applies for 18 months from the date of application of the Regulation. [Art. 1 (1)]

► **Prospectus supplements**
– The Prospectus Regulation requires issuers to publish a supplement to a prospectus in case of "any significant new factor, material mistake or material inaccuracy" in a prospectus that [Art. 23 Prospectus Regulation]
  - affects the assessment of the securities and
  - is recognised between the prospectus' approval date and the closing of the offer period or the trading start.

  As a consequence, investors that have already subscribed for the securities can withdraw their acceptances within two working days after the publication of the supplement [Art. 23 (2) Prospectus Regulation].
– The period within investors may withdraw from their subscriptions for securities in case issuers published a supplement due to significant new factors, material mistakes or material inaccuracies is extended from two to three working days [Art. 1 (7)].
– The Prospectus Regulation requires financial intermediaries to inform any investor that has purchased or subscribed securities through them about the publication of a supplement on the same day [Art. 23 (3) Prospectus Regulation].
– The duty of financial intermediaries to inform investors that purchased or subscribed the securities through them about the publication of a supplement will be restricted to purchases and subscriptions between the prospectus approval date and the closing of the offer period or the trading start. They can do so within one working day after the publication of the supplement. [Art. 1 (7)]

Statement on Subsidiarity by the Commission

The objectives of the amendment to the Prospectus Regulation cannot be achieved by Member States as this would lead to an uneven playing field for issuers and investors, create regulatory arbitrage and hinder cross-border trade.

Legislative Procedure

24.07.2020 Adoption by the Commission
Open Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: Ondřej Kovařík (Renew)
Federal Germany Ministries:	Finance
Committees of the German Bundestag:	Finance
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 114 TFEU (Internal market)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic impact assessment

The duty to publish a prospectus aims at reducing asymmetries of information between issuers and investors. It thus enhances market efficiency and improves the confidence of investors who, in general, are the less informed parties.
The Prospectus Regulation in force [see cep**PolicyBrief** 2016-16] allows for a simplified prospectus for secondary issuances. This is appropriate as investors already received comprehensive information about the issuer and the security at the time of the primary issuance.
Even though there may be room to discuss whether existing prospectus duties for secondary issuances are appropriate – they may be too expensive and may not fit investors' demand for information –, **the COVID-19 pandemic cannot serve as a reason for temporary relaxations of prospectus duties:** The **information asymmetries that exist between issuers and investors do not** simply **vanish during such a pandemic**. On the contrary, the pandemic raises serious questions also on the solvability and liquidity of well-established companies and on the viability of their business models.
Relaxing prospectus duties leaves these questions unanswered also regarding companies that have issued shares – and have published prospectuses – in the past. The EU Recovery prospectus may thus only help companies to raise equity more cheaply and quickly in case investors have enough confidence in their viability, irrespective of the amount of information provided. In lack of such confidence, the new short-form prospectus may rather hamper capital issuance and, what is more, is detrimental to investor protection.
Investor protection will also **suffer from the proposed elevation of the threshold for non-equity issuances of banks** from 75 million euro **to 150 million euro**, although the risks of lending money to banks have not diminished. Again, it is not understandable, why the COVID-19 pandemic should lower investors' need for information on bank issuers and their non-equity security offerings. Irrespective of the exact level of threshold that triggers a duty to publish a prospectus or not, such **thresholds are always arbitrary and give rise to distortions of competition as banks that issue below such threshold profit from lower issuance costs** than those above the limit. As an alternative, a general duty to publish a prospectus independent from any thresholds would be more appropriate. Such general duty should then provide for reasonable minimum levels of information that do justice to the complexity of the respective offer.
The new rules on supplements for prospectuses in case of inaccuracies have two appropriate effects: They **usefully lower the burden for financial intermediaries** who get more time to inform investors about their withdrawal right **while ensuring investor protection** by granting investors a longer withdrawal period.

Legal assessment

Legislative Competence of the EU

The Regulation is correctly based on the internal market competence (Art. 114 TFEU). Harmonisation of prospectus rules strengthens the free movement of capital and reduces distortions of competition. Harmonisation further reduces barriers to cross-border issuance of securities and lowers the uncertainty for issuers and investors about prospectus rules in other Member States.

Subsidiarity

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Impact on and compatibility with German Law

The Regulation applies directly in every Member State so that no national transposition measures are necessary.

Conclusion

The COVID-19 pandemic cannot serve as a reason for temporary relaxations of prospectus duties: Information asymmetries that exist between issuers and investors do not vanish during such a pandemic. Investor protection will suffer from the proposed elevation of the threshold for non-equity issuances of banks to 150 million euros. Thresholds are always arbitrary and give rise to distortions of competition as banks that issue below such threshold profit from lower issuance costs. The new rules on supplements for prospectuses in case of inaccuracies usefully lower the burden for financial intermediaries while ensuring investor protection.

EU-Regulations

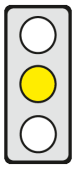
SECURITISATIONS CORONA QUICK FIX

cep**PolicyBrief** No. 2020-11

KEY ISSUES

Objective of the Regulations: Changes to the securitisation rules aim to support the lending capacity of banks in the COVID-19 crisis.

Affected parties: Banks, investors in securitisations.



Pro: (1) The proposed exceptions for NPE-securitisations reflect their specific nature. The proposed easing of prudential rules is acceptable because it is limited to senior tranches of already heavily discounted NPE-exposures.

(2) Even though experience with true-sale securitisations is very limited, preferential treatment for on-balance-sheet synthetic securitisations is acceptable. The minimum requirements regarding the credit protection agreement and the limitation to senior positions that meet additional risk concentration criteria are adequate conditions for such treatment as they significantly reduce risks to banks.

Contra: (1) As the entry into force of rules on the maximum leverage ratios of banks has been delayed because of the COVID-19 crisis, it will be important for supervisors to monitor the impact of the proposed prudential easing on bank leverage.

(2) The proposals risk intensifying the bank–state nexus which may increase systemic risks.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2020) 282 of 24 July 2020 for a **Regulation** of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for **simple, transparent and standardised securitisation to help the recovery from the COVID-19 pandemic**;

Proposal COM(2020) 283 of 24 July 2020 for a **Regulation** of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards **adjustments to the securitisation framework** to support the economic recovery in response to the COVID-19 pandemic.

Brief Summary

Unless mentioned otherwise, articles refer to Articles of Regulation (EU) 2017/2402 as amended by COM(2020) 282.

► **Definitions and context**

– Securitisation refers to the pooling and conversion of credit claims of banks into tradeable securities.
  - In the case of true-sale securitisations, the original creditor of credit claims ("originator") transfers the claims to a third party ("special purpose entity" or SPE) which issues the securities that may be bought by investors.
  - In the case of "synthetic securitisations", the credit claims remain with the originator and only the risks associated with them are transferred to investors.

– Since 2019, an EU Regulation sets out general rules for securitisations and an EU-label for simple, transparent and standardised (STS) securitisations [Regulation (EU) 2017/2402, see cep**PolicyBrief** 2016-04]. It covers true-sale securitisations only. Banks investing in STS-securitisations profit from preferential regulatory treatment.

– Securitisations allow banks to remove credit risks from their balance sheets. This frees up bank capital and increases the lending capacity of banks.

– The proposal is part of an EU Capital Markets Recovery Package. The package also includes amendments to
  - the Markets in Financial Instruments Directive [MiFID II, 2014/65/EU, see cep**PolicyBrief** 2012-17] to alleviate information requirements for investment firms and help nascent energy derivative markets [see cep**PolicyBrief** 2020-09];
  - the Prospectus Regulation [(EU) 2017/1129, see cep**PolicyBrief** 2016-16] creating a new short form „EU Recovery Prospectus" to facilitate the raising of capital in public markets [see cep**PolicyBrief** 2020-10];

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- **Aim and key elements of the proposal**
  - The Commission wants to support the lending capacity of banks and fund the economic recovery after the COVID-19 crisis by
    - adapting the general rules on securitisations to support the securitisation of non-performing exposures (NPEs),
    - extending the definition of STS securitisations to include on-balance-sheet synthetic securitisations,
    - setting minimum requirements for such securitisations regarding the transfer of risk to investors,
    - easing the prudential treatment of securitisations and on-balance-sheet synthetic securitisations.

- **NPE securitisations: exceptions to the general rules for securitisations**
  - Non-performing exposure securitisations – i.e. securitisations backed by a pool of assets of which at least 90% are non-performing [new Art. 2 (24)] – will profit from four exemptions to the general rules on securitisations:
    - Until now, the lender, the originator or the sponsor of the SPE had to retain a material economic interest in the securitised assets ("risk retention"). In future, for securitisations of non-performing exposures (NPE) only, the risk retention may also be fulfilled by the servicer, i.e. the entity managing NPEs on a daily basis. [new Art. 6(1)]
    - Until now, the risk retention was at least 5% of the notional value of the securitised assets. In future, for NPE securitisations only, the risk retention will be set at 5% of the outstanding value of the assets [new Art. 6(3a)].
    - Until now, originators had to ensure that securitised credits satisfied sound criteria for credit granting. In future, as an exemption, originators who buy and securitise credits from a third party that are already non-performing, need not ensure sound credit granting [new Art. 9(1)].
    - In order to lower the level of own funds that must be held by banks investing in NPE-securitisation, senior tranches of NPE-securitisations will be subject to a risk weight of 100% only for those NPE exposures that have been sold to the special purpose entity at a discount of at least 50% [new Art. 269a Regulation (EU) No 575/2013].

- **On-balance-sheet synthetic securitisations as STS-securitisations**
  - On-balance-sheet synthetic securitisations are securitisations where the originator transfers credit risks from its balance-sheet to investors. The originator does so by means of a credit protection agreement with the investor, which includes a premium paid by the originator to the investor and payments by the investor to the originator in case of pre-defined events. As opposed to true-sale securitisations, the exposures are not transferred to an SPE but remain on the balance-sheet of the originator. [new Art. 26b (6) a and b]
  - In future, the definition of STS securitisations will be extended to include certain on-balance-sheet synthetic securitisations. On-balance-sheet synthetic securitisations will qualify as STS securitisations when they fulfil the criteria of:
    - Simplicity: The pool of underlying exposures must be part of the core lending business of the originator which is an EU-regulated financial institution [new Art. 26b (1) and (2)]. It may not contain NPEs [new Art. 26b (11)] and must contain exposures of one type only, which must not be securitisations [new Art. 26b (8)]. The credit-worthiness of debtors must have been adequately assessed and debtors must generally have made at least one payment before the exposures can be securitised [new Art. 26b (10) and (12)].
    - Transparency: The originator must publish default and loss performance data for similar exposures covering at least five years and an independent party must confirm – at least for a sample – that the underlying exposures are covered by the credit protection agreement [new Art. 26d].
    - Standardisation: The originator or original creditor must guarantee a 5% risk-retention. The originator must publish and keep up to date a register of the underlying exposures, including the outstanding notional amount of the exposures. [new Art. 26c]

- **Minimum requirements guaranteeing the transfer of risk for STS on-balance-sheet synthetic securitisations**
  - The credit protection agreement of STS on-balance-sheet synthetic securitisations must meet minimum standards regarding
    - guarantees or collateral transferred by the investor to the originator to back the obligation of the former to pay; such collateral must be cash or zero-risk weight debt securities issued by central banks, governments, public sector entities or international organisations; such zero-risk weight investors do not have to provide collateral [new Art. 26e (7)];
    - the number of credit events (e.g. default, bankruptcy) that trigger a payment by the investor to the originator [new Art. 26e (1)];
    - the risk premium paid by the originator, which must reflect the risk of the underlying exposures and may not be designed so as to reduce the loss allocation to the investor, e.g. by repayments to the investor [new Art. 26e (3) and (6)];
    - the timeliness of payments by the investor to the originator on occurrence of pre-defined events [new Art. 26e (2)].

- **The prudential treatment of securitisations and STS on-balance-sheet synthetic securitisations**
  - Until now, public guarantees for securitisations, i.e. guarantees by a public authority for parts of the securitisations, in which banks invest, allow those banks to maintain a lower level of own funds only when the credit rating

of the guarantor is at least A– at the time of the first credit protection. In future, the rating requirement for public guarantee schemes will be dropped [modified Art. 249(3) Regulation (EU) No 575/2013].
– As regards the senior positions of their on-balance-sheet synthetic securitisations that qualify as STS, banks profit from preferential prudential treatment and do not have to provide as much backing out of own funds as under existing rules. In future, this will apply only to securitisations that meet minimum criteria regarding risk concentration [modified Art. 270 Regulation (EU) No 575/2013].

Statement on Subsidiarity by the Commission

EU-Regulations cannot be amended by Member States.

Legislative Procedure

24 July 2020	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA)
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: Paul Tang [COM (2020) 282], (S&D, NL) and Othmar Karas [COM (2020) 283], (EPP, AT)
Federal Germany Ministries:	Finance
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 114 TFEU (Internal Market)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic impact assessment

Securitisations are, in principle, an economically useful mechanism. They make it easier to spread the risk on the financial markets and increase the potential for banks to grant credit. Since 2019, the STS-label for true-sale securitisations has contributed to combatting the stigma of securitisations that has been linked to the financial crisis and to re-establishing confidence in the securitisation markets.
In past years, banks in many Member States have managed to considerably lower the amount of non-performing loans on their balance sheets. However, the COVID-19 crisis is likely to result once again in a spike in NPE-loans. Hence, the policy aim of making use of NPE-securitisations as a means to remove these NPE-loans from bank balance sheets is laudable, as it frees up banks' capital and thus increases banks' lending capacity. This lending capacity will be necessary to fund the COVID-19 recovery.
The proposed exceptions for NPE-securitisations – regarding the actor required to fulfil the risk retention, its calculation and the fulfilment of sound criteria for credit granting – all **reflect their specific nature**, as opposed to traditional securitisations. **The proposed easing of prudential rules is acceptable because it is limited to senior tranches of already heavily discounted NPE-exposures.** In order to free up capital and have a material effect on banks' lending capacity, it will be necessary for NPE-securitisations to find investors from the non-banking sector, i.e. financial actors such as hedge funds, which are not subject to capital requirements. Moving risks in this way from bank to non-bank balance sheets has a positive impact on lending capacity and may increase risk diversification. However, it does not make these risks disappear, particularly given that capital market investors are likely to invest in junior securitisation tranches, which are subject to higher risks. It will be important for supervisory authorities to closely monitor any risks to financial stability which this risk transfer may cause.
On-balance-sheet synthetic securitisations are comparable to insurances against credit risks. Similar to true-sale securitisations, they can contribute to better risk management. Their contribution to the COVID-19 recovery may be significant for two reasons. First, given the absence of any transactions of claims, on-balance-sheet synthetic securitisations profit from lower transaction costs, especially in the context of a cross-border transfer of risks. Hence, investors throughout the EU may be interested in financing such securitisations. This may enhance the potential to free up bank capital. Secondly, on-balance-sheet synthetic securitisations are mainly used with regard to corporate and SME loans. Lowering borrowing costs for these entities will also contribute to the post-COVID-19 recovery.

The inclusion of on-balance-sheet synthetic securitisations under the STS-label is likely to boost the use of this label by banks, as it is linked to limited preferential prudential treatment in the sense of lower capital requirements. These are necessary to compensate for the costs incurred by banks in complying with the STS-minimum requirements. Without this preferential treatment, STS on-balance-sheet synthetic securitisations would gain little in attractiveness and the label would not contribute to freeing up regulatory bank capital, which helps to increase lending capacities. **Even though experience with STS-true-sale securitisations is very limited, preferential treatment for on-balance-sheet synthetic securitisations is acceptable. The minimum requirements regarding the credit protection agreement and the limitation to senior positions that meet additional risk concentration criteria are adequate conditions for such treatment as they significantly reduce risks to banks.**
However, three risks deserve special attention. First, if successful, the changes proposed by the Commission may lead to an intensive use by banks of synthetic securitisations and thus to less regulatory capital. **As the entry into force of rules on the maximum leverage ratios of banks** – the ratio of a bank's Tier 1 capital to its total non-risk-weighted assets and off-balance-sheet items – **has been delayed because of the COVID-19 crisis** (see cep**PolicyBrief** 2020-06), **it will be important for supervisors to monitor the impact of the proposed prudential easing on bank leverage.**
Second, as all STS-securitisations work as self-certification systems, the originators of securitisations themselves are responsible for compliance with the STS-conditions (see cep**PolicyBrief** 2016-04). Depending on the scale of use of on-balance-sheet synthetic securitisations, it may be very challenging for supervisors to safeguard correct application at all times. At the same time, the consequences of wrong-doing for financial stability may be very severe.
Third, **the proposals risk intensifying the bank-state nexus which may increase systemic risks.** Breaking up this nexus has been one of the lessons of the financial crisis. First of all, Member States may want to act as investors in on-balance-sheet synthetic securitisations. They do not have to provide collateral and banks profit from lower capital requirements. It will be important for the Commission to strictly apply state aid rules if this scenario materialises. Also, the link between banks and states is dangerously increased by the fact that a guarantee for securitisations from States with a credit rating below A– qualifies for lower regulatory capital. In practice, this means that banks will also profit from lower capital requirements for NPE-securitisations backed by a sovereign guarantee from, e.g., Greece or Italy.

Legal assessment

Legislative Competence of the EU

Unproblematic.

Subsidiarity

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

Unproblematic.

Summary and assessment

The proposed exceptions for NPE-securitisations reflect their specific nature. The proposed easing of prudential rules is acceptable because it is limited to senior tranches of already heavily discounted NPE-exposures**.** Even though experience with true-sale securitisations is very limited, preferential treatment for on-balance-sheet synthetic securitisations is acceptable. The minimum requirements regarding the credit protection agreement and the limitation to senior positions that meet additional risk concentration criteria are adequate conditions for such treatment as they significantly reduce risks to banks. As the entry into force of rules on the maximum leverage ratios of banks has been delayed because of the COVID-19 crisis, it will be important for supervisors to monitor the impact of the proposed prudential easing on bank leverage. The proposals risk intensifying the bank–state nexus which may increase systemic risks.