

August 17, 2020

The European Commission Publishes Capital Markets Recovery Package Proposals

In July, the European Commission adopted a series of legislative reform proposals (the “Recovery Package”) aimed at facilitating post-COVID-19 economic recovery. The Recovery Package includes proposals for light-touch adjustments to the Prospectus Regulation¹ and the Markets in Financial Instruments Directive II (“MiFID II”)² and more targeted amendments to the EU securitization framework comprising the Securitization Regulation³ and Capital Requirements Regulation⁴ (“CRR”). These three regulatory frameworks form an integral part of the EU’s Capital Markets Union project⁵ aimed at creating a single EU capital market. Most of the proposals call for temporary relief.

Below is a summary of the key amendments proposed under the Recovery Package.

Summary of the Key Amendments to the Prospectus Regulation

The Recovery Package includes the following proposed modifications to the current prospectus regime. The following are temporary and lapse 18 months after entry into force, except the changes relating to prospectus supplements.

- **EU Recovery Prospectus** – the Recovery Package would create a new short-form prospectus, the EU Recovery Prospectus, to be used for secondary issuances of equity securities by issuers that have had continuously for at least 18 months shares admitted on a regulated market or an SME Growth Market. The EU Recovery Prospectus would not be available for use in initial public offerings. The EU Recovery Prospectus would focus on disclosure of essential information that is material for investors to make an informed decision on whether to invest in the issuer’s securities. It would be limited in length to a maximum of 30 pages, with a new Annex Va to the Prospectus Regulation providing a list of key

¹ Regulation (EU) 2017/1129 (available [here](#)). The targeted adjustments are available [here](#).

² MiFID II comprises the Markets in Financial Instruments Directive (Directive 2014/65/EU) (available [here](#)) and the Markets in Financial Instruments Regulation (MIFIR) (Regulation (EU) No 600/2014) (available [here](#)). The targeted adjustments are available [here](#).

³ Regulation (EU) 2017/2402 (available [here](#)). The targeted adjustments are available [here](#).

⁴ Regulation (EU) 2017/2401 (available [here](#)). The targeted adjustments are available [here](#).

⁵ More information on the objectives of the Capital Markets Union can be found [here](#).

items to be disclosed (in whatever order the issuer chooses to present the information).⁶ Incorporation by reference of information already publicly available in the market would be permitted and such information would not count towards the 30-page limit. A short summary made up of four sections,⁷ with a maximum length of two sides of A4 paper would also be included; however, no cross-references to other parts of the prospectus or incorporation of information by reference would be allowed in the summary. The summary should be presented in an easy to read way, in a language that is clear, non-technical, concise and comprehensible for investors.

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- ⁶ The key items to be provided in the EU Recovery Prospectus (based on Annex Va, available [here](#)) would include:
- The name of issuer, the EU member state of incorporation and a link to the issuer's website.
 - A responsibility statement.
 - The most material risk factors.
 - Financial statements (annual and half-yearly) covering the last 12 months preceding the date of approval of the prospectus (where both have been published and the annual statements post-date the interims, only the annual statements are required), and if applicable pro forma financial information. Where audit reports on the annual financial statements have been refused by the statutory auditors or where they contain qualifications, modifications of opinion, disclaimers or an emphasis of matter, the reason must be given, and such qualifications, modifications, disclaimers or emphasis of matter must be reproduced in full.
 - A description of any significant change in financial position that has occurred since the end of the last financial period for which either audited financial statements or interim financial information have been published, or an appropriate negative statement.
 - Trend information as to production, sales and inventory, and costs and selling prices since the end of the last financial year to the date of the prospectus and information on any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the issuer's prospects for at least the current financial year.
 - The final offer price and amount of shares, including firm commitment from shareholders above 5% and names of the underwriters.
 - Information on when and where to subscribe for the offered shares.
 - The reasons for the offer and the use of proceeds.
 - A working capital statement.
 - Conflicts of interest disclosure.
 - Information on shareholding and voting rights after the issuance.
- ⁷ The four sections would be: (i) an introduction, with a warning; (ii) key information on the issuer; (iii) key information on the securities; and (iv) key information on the offer of securities to the public and/or admission to trading on a regulated market.

These prospectuses would be subject to a fast-track approval procedure of no more than five working days, and issuers would need to notify the competent authority at least five working days before the expected submission date. The EU prospectus passporting rules would apply to these prospectuses. As noted above, the relief would be temporary; prospectuses approved prior to the termination date could continue to be used until the end of their validity or for 12 months after that date, whichever occurs first.

The EU Recovery Prospectus further simplifies disclosure over and above the simplified prospectus introduced in July 2019, which the FCA, for example, encouraged issuers to use in light of COVID-19. As with other short-form disclosure documents such as the simplified prospectus, the use of an EU Recovery Prospectus typically would preclude extending the offering into the United States, unless the intermediaries are prepared to undertake the U.S. portion of the offering on a Section 4(a)(2) basis, rather than the traditional Rule 144A route.

- **Prospectus supplements** – the Recovery Package would simplify the requirements imposed on financial intermediaries in connection with the publication of a supplement to a prospectus. A prospectus supplement is required to be published if a new significant factor, material mistake or material inaccuracy relating to the information in a prospectus arises between the time the prospectus is approved and the closing of the offering. Financial intermediaries are required to contact investors on the day of the publication of the supplement to inform them of the supplement's availability. The Recovery Package would limit the investors required to be informed of the supplement's publication to only those that subscribed and purchased securities through the financial intermediary between the time the prospectus is approved and the closing of the offer period or the time when trading on a regulated markets begins, whichever occurs later.

Additionally, financial intermediaries would be granted one additional day to contact the investors to inform them of the publication of the supplement (*i.e.*, financial intermediaries would contact the relevant investors the day after the publication of the supplement, not on the day of the publication as is currently the case). The time period for the exercise of withdrawal rights by investors would be extended to three (from the current two) working days from the publication of the supplement.

- **Issuances of non-equity securities by banks** – the threshold for exemption from the obligation to publish a prospectus for offers of non-equity securities issued in a continuous and repeated manner by credit institutions would be raised from the current €75 million to €150 million per credit institution calculated over a 12-month period. This would make it easier for credit institutions to obtain new capital that could be used as a low cost and speedy source of financing for companies recovering from the COVID-19-related economic crisis.

Summary of Key Amendments Affecting MiFID II

The Recovery Package proposes the following in relation to MiFID II:

- **Provision of information to clients** – the proposals would revise the rules on how certain information is provided by investment firms to their clients. Under the new rules, the level of information and the method of providing it would be more targeted to the clients' needs in order to free up the valuable resources and make the investment process less costly and time-consuming. The key changes in this area are as follows:
 - the required information relating to investments would only be provided by means of electronic communication, with the paper-based communication no longer being used, with the exception of retail clients that specifically request for the information to be provided in hard, paper copy;
 - the required information on costs and charges, except those relating to provision of investment advice and portfolio management, would no longer be provided to eligible counterparties and professional clients; the proposed exemption would not apply to retail clients who have not opted into the professional client status;
 - where an order for a financial instrument is placed by means of distance communication (*e.g.*, telephone or email), the required information on costs and charges relating to the order would be permitted to be supplied *after* the client is bound by the agreement, provided the investment firm has given the client the option of delaying the transaction *and* the client has consented to receiving the information without undue delay;
 - periodic service statements and loss reports would no longer be provided to eligible counterparties and professional clients; however, professional clients would have the choice to opt-in to receive any or all of such statements and reports; retail clients would continue to receive all service and loss reports but these would be provided on a biannual basis instead of on a quarterly basis;
 - the obligation of trading venues and systemic internalizers to publish best execution reports relating to the quality of execution of transactions would be suspended until 2022; and
 - the required cost-benefit analysis of portfolio activities that involve a product switch would no longer be provided for professional clients, with the exception of clients that specifically opt-in to receiving such analyses.
- **Product governance rules** – the proposals would eliminate the product governance requirements for simple corporate bonds with make-whole clauses by designating such bonds a non-complex product. This would allow issuers to raise capital through issuances of such bonds either by means of a

retail-compliant prospectus with a denomination they consider appropriate or by opting for a shorter prospectus with a denomination of €100,000 or more, directed at more sophisticated investors.

- **Provision of research** – the proposals would introduce an optional exemption from the current unbundling requirement for brokerage and research services relating to small and midcap issuers (*i.e.*, issuers that did not exceed the market capitalization threshold of €1 billion over a 12-month period). Investment firms would have a choice as to whether to continue to unbundle research from brokerage commissions for small and midcap issuers or whether to take advantage of the exemption by combining the two.
- **Position limits in commodity derivative contracts** – the proposals would limit the requirement for application of position limits (which indicate the number of derivative units or lots a trader is allowed to own in a specific derivative) to commodity derivatives traded on trading venues and in economically equivalent OTC derivatives designated as significant or critical and derivatives with agricultural commodities as underlying. The elimination of position limits for the specified derivative contracts would be combined with a targeted hedging exemption that would cover financial counterparties acting within a predominately commercial group.
- **Ancillary test** – the proposals would include simplification to the ancillary activity test (used by non-financial entities to determine whether their trading activity is ancillary to their main business and whether they need MiFID authorizations) whereby all the quantitative elements would be deleted.

Summary of Key Amendments to Securitization Rules

The Recovery Package includes the following modifications to the EU securitization framework that has been in place since January 2019 (ahead of the comprehensive review scheduled to be completed by January 2022, given the potential value of the targeted amendments to post-COVID-19 economic recovery). Securitization is viewed as playing a key role in enhancing the capacity of institutions to support economic recovery, providing an efficient tool for funding and risk diversification for institutions. The European Commission believes that it is essential in the context of the economic recovery post COVID-19 to reinforce the role of securitization and help institutions channel sufficient capital to the real economy. Building on recent work carried out by the European Banking Authority, the European Commission has proposed targeted amendments “to increase the overall risk sensitivity of the EU securitization framework that would make the recourse to the securitization tool more economically viable for institutions within a prudential framework adequate to safeguard the EU financial stability.”

- **On-balance-sheet synthetic securitizations** – the proposals would extend the Simple, Transparent and Standardized (“STS”) securitization framework to on-balance-sheet synthetic securitization (where the originator continues to own the underlying exposures). So-called “arbitrage” synthetic securitizations will not qualify for the STS label.

- **Non-performing exposures (“NPEs”)** – the proposals would address recently identified regulatory obstacles to the securitization of NPEs. The targeted amendments would introduce a definition of NPE securitization, allowing risk retention in the case of NPE portfolios to be based on the discounted value of the portfolio (rather than nominal values) and allowing a servicer to take on the risk retention slice given its position in the structure that ensures its interests are aligned with those of the investors. The proposals would clarify the verification duties of originators of NPE securitizations.
- **Capital treatment** – changes to the CRR would see the introduction of more risk-sensitive capital treatment of NPE securitizations and of the senior tranche of STS on-balance-sheet securitizations.

Next Steps

The Recovery Package proposals will need to be reviewed and agreed upon by the European Parliament and the Council. Once finalized and adopted, the Recovery Package amendments will enter into force, with the changes to the Prospectus Regulation and the securitization framework applying automatically in EU member states and the MiFID amendments requiring transposition under national laws of the individual member states. The impact in the UK depends on whether the measures enter into force before December 31, 2020.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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