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Banking & Finance

4th Debt Capital Markets Seminar

2021 DCM Developments in the Shade of the COVID-19 Pandemic

Webinar | 26 January 2021

Welcome

Barry Cosgrave
Partner
Restructuring
London
E bcosgrave@mayerbrown.com
T +44 20 3130 3197

Anna T. Pinedo
Partner
Corporate & Securities
New York
E apinedo@mayerbrown.com
T +1 212 506 2275

Dr. Patrick Scholl
Partner, Head of Banking & Finance Germany
Frankfurt
E pscholl@mayerbrown.com
T +49 69 7941 1060

James Taylor
Partner
Banking & Finance
London
E jtaylor@mayerbrown.com
T +44 20 3130 3136

Dr. Berthold Kusserow, LL.M.
Senior Counsel
Banking & Finance
Frankfurt
E bkusserow@mayerbrown.com
T +49 69 7941 2995

Bradley Berman
Counsel
Corporate & Securities
New York
E bberman@mayerbrown.com
T +1 212 506 2321

Alexei Döhl, LL.M.
Senior Associate
Banking & Finance
Frankfurt
E adoehl@mayerbrown.com
T +49 69 7941 1105

Agenda

Topic and speaker	Time (CET)
Dr. Patrick Scholl **Welcome**	3:00 p.m. - 3:05 p.m.
Bradley Berman, Anna T. Pinedo, James Taylor, Dr. Patrick Scholl, Alexei Döhl **Updates on the IBOR transition, governmental actions, use of RFR in DCM products, New ISDA EURIBOR Fallbacks and EURIBOR Fallback consultation**	3:05 p.m. - 3:50 p.m.
Anna T. Pinedo, Dr. Patrick Scholl **Sustainability linked Bonds and EU Green Bond regulation**	3:50 p.m. - 4:10 p.m.
Barry Cosgrave, Dr. Patrick Scholl **Bonds and Schuldscheine and COVID-19 restructuring**	4:10 p.m. – 4:30 p.m.
Dr. Berthold Kusserow, Dr. Patrick Scholl **Electronic and Crypto Securities in Germany**	4:30 p.m. – 5:00 p.m.

Your questions are welcome at any time of the presentation using the „Chat" function.

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Bradley Berman, Anna T. Pinedo, James Taylor, Dr. Patrick Scholl, Alexei Döhl

Updates on the IBOR transition, governmental actions, use of RFR in DCM products, New ISDA EURIBOR Fallbacks and EURIBOR Fallback consultation

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GBP LIBOR

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GBP LIBOR Transition – Setting the Scene

- 315 Floating Rate Notes and 170 securitisations with 560 tranches (total value of £110b) mature after 2021
- Fall-backs vary in these GBP LIBOR Notes:
  - ***Type 1 Fallbacks (around 70%)***: default to last available LIBOR fix (i.e. floating rate will become a fixed rate for the remaining tenor of the notes)
  - ***Type 2 Fallbacks (around 30% issued broadly from FCA's announcement of LIBOR cessation in July 2017):*** benchmark discontinuation provisions which provide for benchmark replacement and adjustment spread without noteholder consent to a "successor" or "alternative" rate on the permanent cessation of LIBOR
  - ***Type 3 Fallbacks (from 2019):*** Similar to Type 2 Fallbacks, but pre-cessation triggers on announcement of non-representativeness of LIBOR by supervisor of administrator of benchmark also triggers benchmark replacement

GBP LIBOR Transition – Setting the Scene (cont'd)

- Regulatory recommendations?
  - ***Successor Rate:*** no recommended Successor Rate by relevant nominating body
  - ***Adjustment Credit Spread:*** Bank of England's Sterling Risk-Free Rate Working Group (RFRWG) recommended use of five-year median spread adjustment methodology to be applied to the relevant Sterling Overnight Index Average (SONIA) rate chosen or recommended to replace GBP LIBOR (i.e. the median of the spread between LIBOR and SONIA over a five year look-back period)
    - Recommendation based on consensus response of market practitioners to ISDA's consultation on Credit Adjustment Spread Methodologies
- Litigation risk? If no recommended Successor Rate, then fallbacks would default to an Alternative Rate customarily applied for the purposes of determining rates of interest – with Issuer/Calculation Agent making determination
  - Litigation risk in the event of challenges to the determined rate

GBP LIBOR Transition – SONIA Developments

- RFRWG's preferred risk free rate (RFR) is SONIA:
  - regulators deem overnight rates to be most robust
  - applied in the Overnight Index Swaps market for decades, volume of underlying observable transactions large, and rate can be argued to be representative and pricing to be fair and not linked to expert judgment of a set of panel banks (in comparison to LIBOR)
- Applied in the SONIA Floating Rate Note Markets universally as a Compounded in Arrears rate
- NO LONGER EXPECTED that bond markets will shift to forward-looking Term SONIA rates once operational

GBP LIBOR Transition – SONIA Developments (cont'd)

- Until January 2020, all new SONIA floating rate note issuance used same Compounded in Arrears conventions:
  - Overnight SONIA compounded in arrears over the interest period
  - Five-day look-back employed with a customary (minimum) 5-day look-back period:
    - So rate applied in the calculation of SONIA in any day in the interest period is the rate set out on Relevant Screen Page (SONIAOSR=) five London Banking Days prior to that date (the so called Observation Period)
    - Observation Period ends five-days prior to the Interest Period so Interest Rate and Interest Amount determined ahead of relevant Interest Payment Date which allows for certainty of cash flows for issuers and investors
  - *Lag Method:* Interest calculated according to number and weighting of days in the Interest Period (not the Observation Period) despite the look-back

GBP LIBOR Transition – SONIA Developments (cont'd)

- Margin added once interest rate calculated
- If SONIA not available on any day in the Interest Period / Observation Period, rate defaults to the Bank of England's Bank Rate plus the mean of the spread of SONIA to the Bank Rate over previous 5 Banking Days

GBP LIBOR Transition – SONIA Developments (cont'd)

- 27 February 2020, EBRD issued first floating rate notes using the shift method
  - Interest calculation according to the number and weighting of days in the Observation Period (not the Interest Period as is the case with the lag method)
  - Weighted dates are those screen rate observation dates and SONIA Rates used in the calculation of interest
- 3 August 2020, Bank of England began publishing SONIA Compounded Index to standardise and simplify method of calculating SONIA-linked payments (application of compounding and treatment of non-London Banking Days)
  - EIB launched new issue of floating rate notes in August 2020 pegged to the Index
  - Bank of England's RFRWG acknowledges move to shift method may involve adapting IT systems and revising documentation and that existing floating rate notes employing lag method remain fine
  - Move to shift method considered more of a problem for the loan markets than the bond markets

GBP LIBOR Transition – Term SONIA Rate Development

- FCA / RFRWG expect around 10% of UK lending market (not bond markets) to opt for forward-looking versions of the SONIA Rate (SONIA Term Rates)
  - E.g. specific segments of the lending market such as trade finance
- Term SONIA Rates have been developed by ICE Benchmark Administration (ICE), Refinitiv and FTSE Russell and ICE and Refinitiv have finalised their rates and are negotiating licencing agreements with clients
  - one-, three-, six- and 12 month tenors
  - Use SONIA OIS quotes provided in interdealer central limit order books such as Tradition (CLOBS)
  - Waterfall of back-up data – negotiable dealer – to – client data from Tradeweb (active trading data, which has been available in volume through the COVID pandemic)
  - ICE provides for additional fallback to SONIA futures data listed at ICE Futures Europe

GBP LIBOR Transition – The Legacy Contract Dilemma

- What about lending markets that cannot transition naturally to Compounded in Arrears SONIA or Term SONIA?
  - RFRWG issued paper on 21 October 2020 that referred to certain tough legacy exposures in the UK for which action may be required by the legislator
- UK Financial Services Bill published 18 November 2020 provides for amendments to the Benchmarks (Amendment) (EU Exit) Regulations 2018 to insert into on-shored version of EU Benchmarks Regulation new powers for the FCA
  - FCA will be empowered to direct administrator of LIBOR to change
  - methodology used to compile critical benchmark if doing so would protect consumers and market integrity
  - FCA will need to first determine critical benchmark is not representative of the market is seeks to measure and that representativeness will not be restored

GBP LIBOR Transition – The Legacy Contract Dilemma (cont'd)

- FCA is to further consult with stakeholders on approach to methodology change and fixed credit spread, but warns that any methodology change may not be able to replicated preferred structures in the markets that have already moved to RFRs
- FCA / RFRWG made clear in May 2020 that it requires wherever possible markets to actively transition to SONIA and this should remain the central goal of markets and businesses
- ICE released consultation in December 2020 that it intend to cease publication of GBP LIBOR on 31 December 2021
  - 315 Floating Rate Notes and 170 securitisations with 560 tranches (total value of £110b) mature after 31 December 2021
  - Legacy LIBOR notes must be amended note by note – not possible to use protocols to convert note market as a whole

GBP LIBOR Transition – The Legacy Contract Dilemma (cont'd)

- Consent solicitations (circa 40 floating rate note/reset note/covered bond transactions for GBP30bn in principal amount):
  - ***Floating Rate Notes:*** Issuers seek consent of investors to convert their notes from LIBOR to SONIA
  - ***Covered Bonds:*** Issuers elect to trigger benchmark replacement conditions and obtain "negative consent" (no objections above 10% principal amount of Noteholders)
  - Consent thresholds have been achieved at close to 100% ("so far so good")
  - Credit adjustment spread based on linear interpolation for relevant tenor of LIBOR versus SONIA basis swaps, which is then added to the original margin of legacy LIBOR-liked notes
- Other methods for issuer's to transition: Cash tender offers (buy-backs), Exchange offers, Market repurchases (ad hoc) etc.

USD LIBOR

USD LIBOR Transition – What's New?

- Recent ICE Benchmark Administration announcements:
  - it intends to cease publication of 1-week and 2-month USD LIBOR at the end of 2021;
  - subject to compliance with applicable regulations, it does not intend to cease publication of the remaining USD LIBOR tenors until June 30, 2023; and
  - all GBP, EUR, JPY, and CHF IBOR tenors will cease publication after December 31, 2021.

USD LIBOR Transition – What's New? (cont'd)

- Regulators' responses:
  - Joint statement of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, and a press release by the Board of Governors of the Federal Reserve System
    - Banks are encouraged to stop entering into new USD LIBOR contracts "as soon as practicable," and by no later than December 31, 2021;
    - Entry into such contracts after December 31, 2021, would create safety and soundness risks for banks;
    - The USD LIBOR June 30, 2023, cessation date will allow more time for existing legacy USD LIBOR contracts to mature; and
    - Banks should use this extra time to continue to prepare for the transition away from LIBOR.

USD LIBOR Transition – What's New? (cont'd)

- Allows more time for back-office systems to prepare for SOFR calculations, which will be required when more recently issued USD LIBOR FRNs that include the Alternative Reference Rate Committee's ("ARRC") USD LIBOR-to-SOFR fallback provisions switch over to SOFR upon a USD LIBOR cessation.

Legislative Solutions

- New York State legislative solution for New York law-governed financial instruments (including floating rate notes):
  - Now part of the New York State budget, to be approved by Gov. Cuomo
  - Would nullify the polling provisions in legacy USD LIBOR floating rate notes and go directly to the ARRC fallbacks
  - Vulnerable to a challenge due to potentially conflicting with the Trust Indenture Act of 1939
    - If challenged, possible that it could be invalidated solely with respect to floating rate notes, leaving it effective for loans and securitizations

Legislative Solutions (cont'd)

- Federal legislative solution:
  - Does not have the Trust Indenture Act conflict, a federal statute carefully worded to avoid a conflict with Section 316(b) of the TIA
  - Has a sponsor in the House of Representatives
- If either legislative solution comes into law, problem of legacy floating rate notes defaulting into fixed rate notes will be solved. It would be best if the federal proposal came into law.

Legislative Solutions (cont'd)

- What if there is no legislative solution?
  - Liability management concerns for issuers and trustees
  - Exchange offers, tender offers, buyback programs
  - Consent solicitation an open question absent SEC guidance

SOFR Offerings

- There have been a number of SOFR floating rate note offerings. We've seen all three ARRC SOFR compounding formulae used.
  - Trend toward using SOFR Index with observation period shift for retail investors
    - SOFR Index is easier to understand, compare two points in the index, no messy compounding formulae
  - Term SOFR isn't ready yet

SOFR Offerings (cont'd)

– Potential competitor rate: AMERIBOR (American interbank offered rate), overnight unsecured rate of loan transactions on the American Financial Exchange, LLC (AFX);
  - Has a credit spread component
  - Citibank joined the AFX in December 2020
  - Reflects actual borrowing costs of small, medium and regional U.S. banks that do not borrow at either USD LIBOR or SOFR to fund their balance sheets

Other Rates

- CMS Rate:
  - Has a USD LIBOR component for the floating rate leg
  - When including in a prospectus, ensure clarity as to what happens after June 2023
  - USD LIBOR component will follow the new fallbacks in ISDA Supplement No. 70, ultimately falling back to SOFR
  - Adjust risk factors accordingly
  - Presently, no concerns about a CMS Rate cessation
- 11th District Cost of Funds Rate will cease publication after January 31, 2022

EURIBOR

ISDA Fallback Supplement provisions related to EURIBOR

- On 10 October 2020, ISDA published the IBOR Fallbacks Supplement (Supplement No 70 to the 2006 ISDA Definitions) as well as the ISDA 2020 IBOR Fallbacks Protocol to transition ISDA derivatives and other derivatives to RFRs.*
- In addition, bilateral amendment agreements have been published.
- These changes became effective on 25 January 2021, accordingly FRN hedges are now based on these new standards if the issuer of the FRN and its swap counterparty adhered to the protocol or apply the Supplement 70 for new hedges.
- EURIBOR floating rate option fallback provisions have been amended and provide for the following waterfall structure:

* A User Guide to IBOR Fallbacks and Risk-free Rates is available at http://assets.isda.org/media/ae17cd3b/67b6c088-pdf/.

ISDA Fallback Supplement provision related to EURIBOR

Unavailable screen rate, No cessation	**Cessation**
1. rate formally recommended by administrator	1. Cessation of EURIBOR: replacement by Fallback Rate (EuroSTR) (=term adjusted €STR plus spread relating to EURIBOR published by Bloomberg Index Services Limited) a. if such rate is temporarily not available, most recently provided rate
2. rate formally recommended by supervisor	2. cessation of Fallback Rate (EuroSTR): EuroSTR plus most recently published spread, including adjustments by Calculation Agent necessary to account for any difference in term structure or tenor a. if such rate is temporarily not available, last provided EuroSTR
3. commercially reasonable alternative rate used by central counterparties (CCPs) and/or futures exchanges	3. cessation of fallback rate for EuroSTR: ECB recommended rate plus most recently published spread, including adjustments by Calculation Agent necessary to account for any difference in term structure or tenor a. if such rate is temporarily not available: last provided ECB recommended rate
	4. No ECB recommended rate or cessation of recommended rate: modified Eurosystem Deposit Facility Rate (EDFR) (plus EDFR Spread) plus most recently published spread, including adjustments by Calculation Agent necessary to account for any difference in term structure or tenor a. if such rate is temporarily not available, last provided modified EDFR

Update on EURIBOR – EU RFR Working Group Consultation

- On 23 November 2020, two public consultations on €STR-based EURIBOR fallbacks rates have been launched and a roundtable discussion was held on.
  - Consultation 1 refers to fallback trigger events.
  - Consultation 2 refers to the most appropriate fallback adjustments for each financial product assessed against a list of key criteria and spread adjustment.

Update on EURIBOR – EU RFR Working Group Consultation 1

Trigger Events

1. Public statement by the supervisor of EURIBOR administrator that the EURIBOR administrator has ceased or will cease permanently or indefinitely the provision of EURIBOR
2. Public statement by EURIBOR administrator to permanently or indefinitely has ceased or will cease the provision of EURIBOR
3. Official public statement by supervisor of the EURIBOR administrator that EURIBOR is no longer representative (pre-cessation trigger)
4. EURIBOR administrator determines that EURIBOR should be calculated in accordance with its reduced submissions or other contingency policies
5. Use of EURIBOR has become unlawful for the relevant parties
6. EURIBOR is permanently no longer published without a previous announcement
7. Material Change to EURIBOR methodology

Update on EURIBOR – EU RFR Working Group Consultation 2

Adjustments

1. €STR-based term structure:

   - Forward-looking (FWL) term structures (where interest is know at the start of the interest period), for example for retail mortgages or consumer loans or SME loans or trade finance → to the extend available, otherwise BWL
   - Backward-looking (BWL) term structures (where interest is based on a mathematical calculation of past realised daily fixings over a period of time) using either **payment delay** / **lookback period** / **last reset** methodology for specific asset classes → for more sophisticated and globally operating market participants BWL with lookback period (with observation shift instead of lag approach) seems to be most appropriate (also for debt securities)

2. Spread adjustment methodology: allowing a value neutral transition by using the historical mean / median spread adjustment methodology (consistent with spread adjustment in ISDA derivatives)
3. BWL market convention: Recommendation to use the compounded average methodology (without floor for €STR but to the sum of €STR + adj. spread)

Proposed statutory benchmark replacement powers in the EU

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The proposed statutory benchmark replacement powers

- Current proposal* includes several improvements when compared to initial proposal from the Commission
- Aim of the proposed amendment is to avoid:
  - Significant disruption in the functioning of financial market in the EU
  - Avoid contract frustration and legal uncertainty
  - Potential impacts on market integrity and financial stability
- Commission will be provided with the powers to designate a replacement for a benchmark that will permanently be ceased or wind-down
- Replacement powers of national competent authority where the majority of contributors is located

* Based on the final compromise text for the proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation agreed between the European Council and the European Parliament dated 8 December 2020

Instruments in scope of the new replacement powers of the Commission

- Contracts and financial instruments as defined in MiFID II subject to the law of a Member State
- Contracts subject to the law of a third country if
  - All of the parties to the contract are established in the EU **and**
  - The law of that third country does not provide for an orderly wind-down of a benchmark
- Contract or financial instrument does not include a “suitable contractual fallback provision”
- Term “contract” is not defined in the proposal

Scope of the new replacement powers

- Applies to critical benchmarks provided by administrators located within the EU
- Benchmarks based on the contribution of input data if their cessation would result in a significant disruption in the functioning of financial markets in the EU
- Third country benchmarks if their cessation would result in a significant disruption in the functioning of financial markets or pose a systemic risk for the financial system in the EU

Replacement Trigger

- Public statement or information of the **competent authority** of the administrator that the capability of that benchmark to measure the underlying market or economic reality cannot be restored (pre-cessation trigger)
- Public statement or information by **the administrator** that it will commence the wind-down of that benchmark or will cease to provide that benchmark permanently and there is no successor administrator
- Public statement or information of the **competent authority or insolvency or resolution authority of** the administrator that the administrator will commence the orderly wind-down of that benchmark or will cease to provide that benchmark permanently and there is no successor administrator
- **Competent authority** withdraws or suspends the authorisation, withdraws the recognition or ceases the endorsement of the administrator and there is no successor administrator

Replacement Procedure

- Commission adopts implementing acts to designate one or more replacements for a benchmark including the following:
  - The replacement for the benchmark concerned
  - The spread adjustment, including the method for determining such spread adjustment
  - The corresponding essential conforming changes
  - The relevant date from which the replacement for a benchmark shall apply
- When adopting the implementing act, the Commission shall take into account the recommendations made by the relevant central banks or alternative reference rate working group in particular operating under the auspices of public authorities or the central bank
- Before adopting the implementing act the Commission shall conduct a public consultation and shall take into account the recommendations of other relevant stakeholders, including the competent authority of the benchmark administrator and ESMA
- Commission may apply different replacement methods for different types of contracts/financial instruments or markets

Consequences of the replacement

- All references to the benchmark in contracts and financial instruments are replaced where those financial instruments and contracts contain
  - no fallback provision; or
  - no suitable fallback provisions
- **Exemption**: Replacement benchmark shall not apply where all parties or the required majority of a contract or financial instrument have agreed to apply a different replacement for a benchmark before or after the entry into force of the implementing act.

Unsuitable contractual fallbacks in contracts or financial instruments

- Contractual fallback does not cover the permanent cessation of the benchmark; or
- Application of fallback requires further consent from third parties that has been denied; or
- Application of fallback no longer, or only with a significant difference, reflects the underlying market or the economic reality that the ceasing benchmark is intended to measure, and could have an adverse impact on financial stability, which is determined as follows:
  - the national relevant authority has established the facts mentioned above;
  - one of the parties to the contract has objected to the contractually agreed fallback provision at the latest three months before the permanent cessation of the publication of the benchmark
  - the contracting parties have not agreed on an alternative fallback provision following such objection at the latest one working day before the permanent cessation

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Sustainability linked Bonds and EU Green Bond regulation

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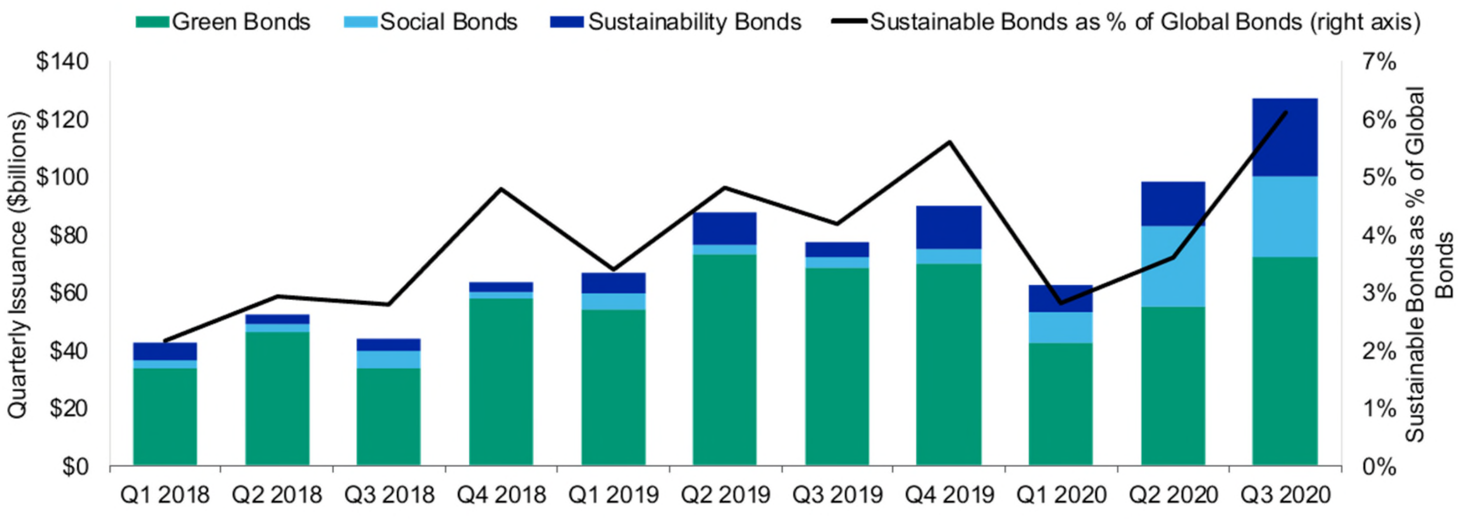
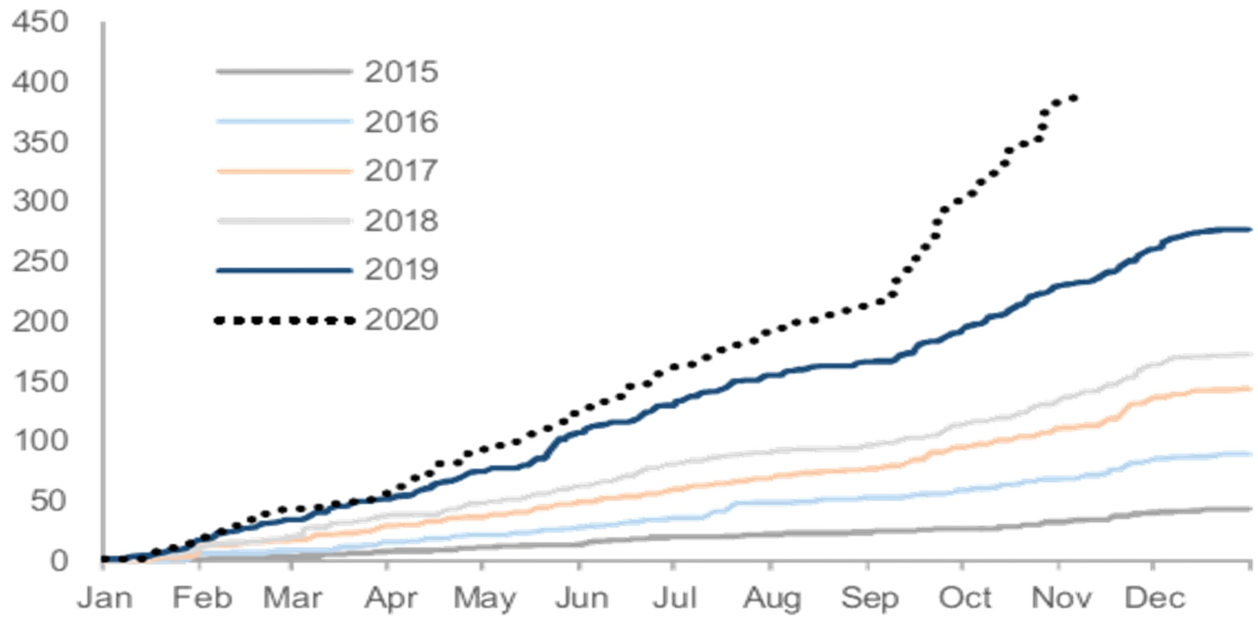
Sustainability linked Bonds

Moody's Sustainable Finance Market Update



Sources: Climate Bonds Initiative, Dealogic and Moody's Investors Service

JPMorgan Market Update



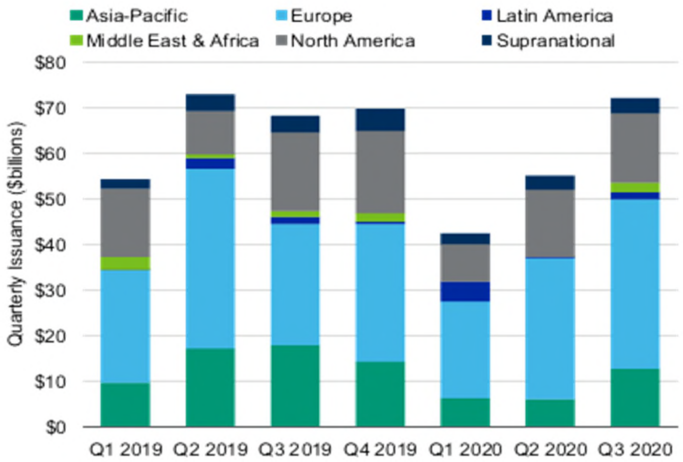
Source: J.P. Morgan, Bloomberg Finance L.P., Dealogic. Including GSS bonds up to 4 Nov 2020

What are green bonds?

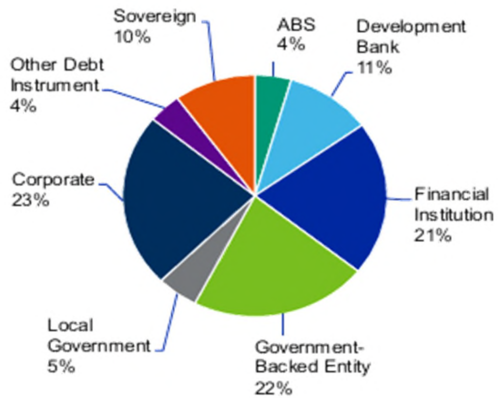
- Green Bonds are any type of bond instrument or loan financing where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects
- The GBP explicitly recognize several broad categories of eligibility for Green Projects, which contribute to environmental objectives such as: climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control
- The GBP were introduced to formalize perceived market 'best practices' and to encourage transparency and reporting; however, they are voluntary and there are concerns regarding "greenwashing"

Moody's Sustainable Finance Market Update

Green bond issuance returned to 2019 levels in the third quarter



Sources: Climate Bonds Initiative and Moody's Investors Service



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What are sustainability-linked bonds?

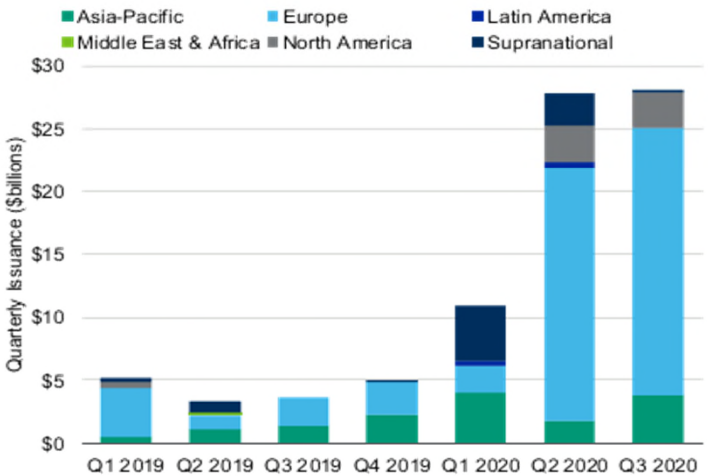
- Sustainability-Linked Bonds (SLBs) are any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability / ESG objectives.
- SLBs incentivise the issuer's achievement of material, quantitative, pre-determined, ambitious, regularly monitored and externally verified sustainability (ESG) objectives through Key Performance Indicators (KPIs) and Sustainability Performance Targets (SPTs).
- The proceeds of SLBs are intended to be used for general purposes.
  - Not "use-of-proceeds bonds" (i.e. unlike "Green Bonds", "Social Bonds" or "Sustainability Bonds")

Moody's Sustainable Finance Market Update

- Sustainability-linked bonds set for growth
- Debut sustainability-linked bonds (SLBs) from Italian utility Enel in 2019 launched market interest
- Instruments offer the flexibility of general corporate purposes borrowing, while still allowing issuers the ability to highlight their enterprise-wide sustainability objectives
- Three transactions in the third quarter point toward further growth:
  - Brazilian pulp and paper company Suzano S.A., $750 million SLB, tied to reducing its greenhouse gas emissions intensity
  - Swiss pharmaceuticals company Novartis AG, €1.85 billion SLB, tied to the achievement of social targets
  - French fashion house Chanel, €600 million SLB, tied to decreasing its carbon emissions and shifting to 100% renewable electricity in its operations
- Publication of ICMA **Sustainability-Linked Bond Principles (SLBP)** in June 2020 supports market standardization
- Announcement from ECB that **sustainability-linked bonds will become eligible as central bank collateral** beginning in January 2021 further bolsters market

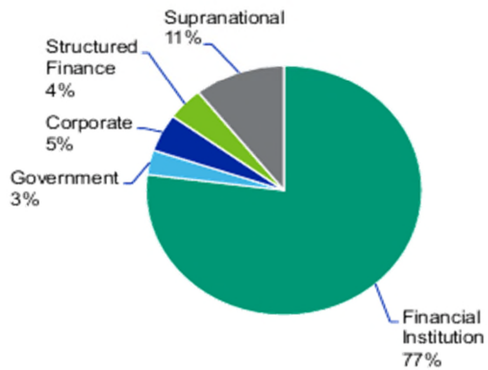
Moody's Sustainable Finance Market Update

Pandemic propels social bond issuance to new heights



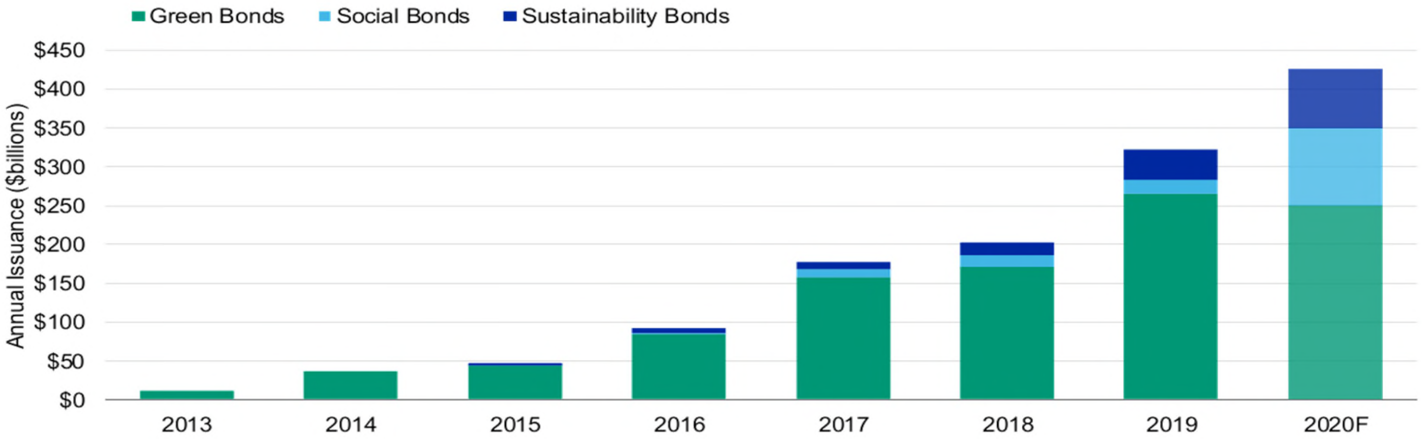
Sources: Dealogic and Moody's Investors Service

Percent of Q1-Q3 2020 global social bond issuance



Moody's Sustainable Finance Market Update

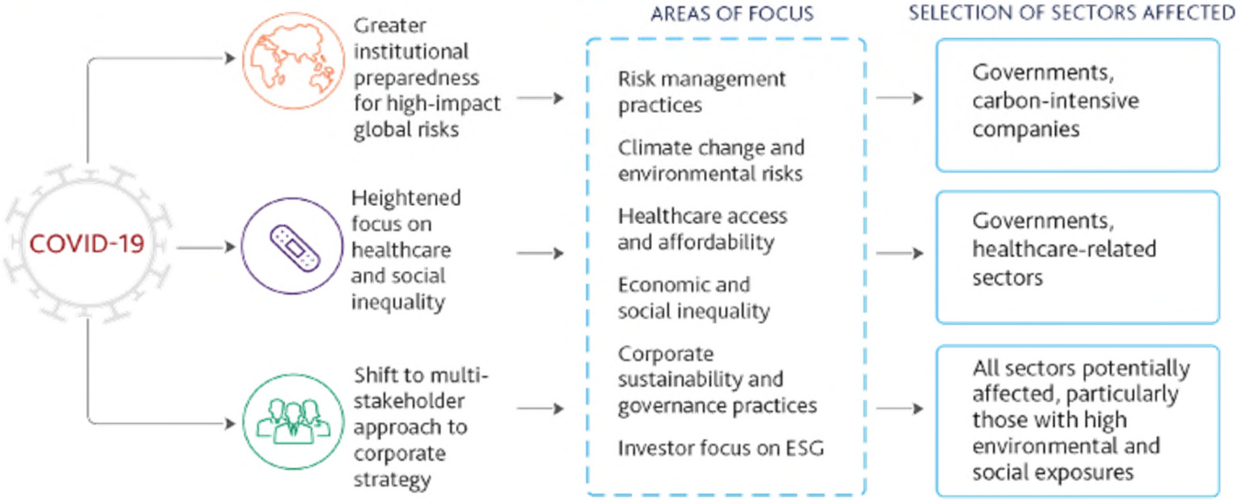
Sustainable bonds to set new issuance record in 2020 despite coronavirus-related disruptions



2020F represents Moody's Investors Service 2020 full-year forecast.
Sources: Climate Bonds Initiative, Dealogic and Moody's Investors Service

Moody’s Sustainable Finance Market Update

ESG risks will come into greater focus, supporting sustainable bond issuance



Source: Moody's Investors Service

US Developments During the Pandemic Period

- In addition to the overall increase in issuance levels during 2020, we also have seen:
  - An increase in issuance of green convertible bonds;
  - An increase in issuance of, and a more diverse array of, social bonds, including pandemic bonds, use of proceeds bonds focused on minority and other social justice issues
  - An increase in first-time and first-time US dollar issuers
  - Increased reliance on third-party verifiers for use of proceeds bonds

EU Green Bond regulation

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EU Green Bond Standard: Background

- As part of its broader Action Plan on Financing Sustainable Growth, the European Commission plans to establish an **EU Green Bond Standard** (EU GBS).
- The EU GBS adds to an evolving EU regulatory framework for establishing long-term signals to direct financial and capital flows towards green investments.
- Most notably this regulatory framework already includes the **Disclosure Regulation** (coming into force on 10 March 2021), establishing reporting and disclosure requirements with respect to sustainable characteristics of certain financial products, as well as the **Taxonomy Regulation** as the centerpiece of the regulatory framework, providing definitions and technical requirements aimed towards, establishing a uniform EU Taxonomy for sustainable finance, upon which other legislation can rely.

EU Green Bond Standard: EU Taxonomy

- The EU Taxonomy sets out four principles for eligibility:

    1. Contribute to one or more of the six **environmental objectives** (climate change mitigation; climate change adaptation; sustainable use and protection of water and marines resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; protection of healthy ecosystems).
    2. **Do no significant harm** to any other environmental objective.
    3. Comply with **minimum social safeguards**.
    4. Comply with the **technical screening criteria**.

EU Green Bond Standard: Current status and next steps

- The Commission's Technical Expert Group on Sustainable Finance (TEG) published their Proposal for an EU Green Bond Standard in June 2019 and provided more detailed guidance in the Usability Guide published in March 2020. In the meantime, two consultations have been conducted by the European Commission, the last of which ended in October 2020. This will form the basis for the European Commission's decision on how to move forward. Adoption of the EU GBS is intended for 2021.
- The form in which the EU GBS will be initially published has not yet been decided (informal publication at first seems to be likely, e.g. in the form of a recommendation or communication).
- Following the establishment of the EU GBS, external verifiers for the EU GBS will be invited to join a voluntary interim registration scheme for a period of up to 3 years.
- At the end of this period, during which the success of the EU GBS will be evaluated, legislative action shall be taken and a formal registration scheme will be established for the external verifiers.

EU Green Bond Standard: Key elements (1/2)

- An EU Green Bond is any type of listed or unlisted bond or capital market debt instrument issued by any European or international issuer that will be aligned with the EU GBS, and will therefore meet the following requirements:[1]

Green Bond Framework aligned with EU GBS	Proceeds exclusively used to (re)finance Green Projects (based on the EU Taxonomy)	External verification

[1] see Usability Guide for the EU Green Bond Standard (9 March 2020): Annex 1: Draft Model of the EU Green Bond Standard.

EU Green Bond Standard: Key elements (2/2)

- **Definition of Green Projects**: Aligned with the EU Taxonomy. Additional criteria are set out in the draft EU GBS (look-back period, eligible expenditures).
- **Green Bond Framework**: including objectives, processes, methodology for allocation etc. (template provided in the EU Green Bond Standard Usability Guide).
- **Reporting**: mandatory reporting on allocation and impact (template provided in the EU Green Bond Standard Usability Guide). Only one allocation report is necessary for Green Bond Programmes (programmes with several bond issuances under the same Green Bond Framework).
- **Verification**: an accredited verifier confirms the alignment of the GBF before/at issuance and of the allocation after full allocation of the proceeds has been achieved. Verification of impact reporting is not mandatory, but encouraged.

EU Green Bond Standard and the ICMA GBP

- The EU GBS builds on the ICMA Green Bond Principles as well as market practice.
- Many of the criteria described in the ICMA GPB as “recommended” will be “required” under the EU GBS. This includes:
  - Including the Use of Proceeds in the legal documentation (e.g. Base Prospectus or Final Terms)
  - Disclosure of the proportion of proceeds used for green refinancing
  - Allocation and impact reporting
  - External verification (pre and post issuance)
- Verifiers under the EU GBS will be accredited under a centralized scheme, operated by ESMA.
- The definition of Green Projects provides the link from the EU GBS to the Taxonomy Regulation which in contrast to the high-level descriptions of the ICMA GBP sets out very specific eligibility criteria.

EU Green Bond Standard: Uncertainty for market participants?

- The two consultation rounds demonstrated that market participants are still uncertain about the future implementation of the EU GBS.
- In detail, the answer to the following questions is awaited:
  - Will there be a grandfathering for sustainable products that already follow alternative standards, such as the ICMA Green Bond Principles? This applies likewise to products issued under the future EU GBS, as these standards will also be subject to ongoing development.
  - What is considered to be a reasonable period of time to take the appropriate measures necessary to comply with the EU GBS?
  - Is any financial support of the reporting and/or verification process planned? A possible subsidy, to offset the additional cost of external verification/second opinion, or targeted fiscal incentives, are likely to increase the attractiveness of green bonds as they offset the issuance costs with conventional bonds.

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Barry Cosgrave, Dr. Patrick Scholl

Bonds and Schuldscheine and COVID-19 restructuring

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Restructuring Bonds – types of bond

- Types of bond
  - Reg S (Covenant light; English law governed)
  - 144A (High Yield Bonds; New York law governed)
  - Schuldscheine (German law governed)
- Parties involved
  - Issuer
  - Trustee
  - Noteholders
  - Paying Agents
  - Security Trustee?

Restructuring Bonds: decision making process

- Collective Action Clauses and Reserved Matters
  - Reg S vs 144A
  - Supermajority consents
- Restructuring options
  - Tender Offer
  - Consent Solicitation
- Noteholder identification and calling meetings
  - Who calls the meeting
  - Notice provisions

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Restructuring Bonds: Issues to consider

- Bonds vs Schuldscheine
- Lock-up agreements; controlling positions
- Inside information; cleansing statements
- Fair treatment of Noteholders and the Assenagon case
- Alignment of bondholder interests
- COMI shift and schemes of arrangement
  - Post-Brexit Schemes
- Enforcement of Security

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Dr. Berthold Kusserow, Dr. Patrick Scholl

Electronic and Crypto Securities in Germany

Digital Securities: The new normal?

A summary of the main features of the German Draft Act on the Introduction of Electronic Securities ("ESA")

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Overview

- Legislative History and Purpose
- Eligible Securities
- Ineligible Securities
- Grandfathering
- Optionality and Registration Requirement
- Available types of ESRs
- Primary Market: Creation Process
- Primary Market: Filing Requirements
- Secondary Market: Transfer of Ownership in Central Register
- Secondary Market: Transfer of Ownership in Crypto Securities Register
- Operational Requirements
- Liability Issues

Legislative History and Purpose

- Legislative History
  - White Paper („*Eckpunktepapier*“): 7 March 2019
  - Ministerial Draft Act („*Referentenentwurf*“): 10 August 2020
  - Government Draft Act („*Regierungsentwurf*“): 16 December 2020
  - Adoption and enactment of the Electronic Securities Act (“ESA“): until summer 2021

Legislative History and Purpose (cont'd)

- Legislative Purpose
  - Modernize German Securities Law, which is still based on definitive (global) certificated, to be immobilized in the vaults of a CSD
  - Introduce as an option
    - Digital electronically registered bearer bonds ("electronic bonds" or "EBs")
    - Digital electronically registered fund units ("electronic fund units" or "EFUs")
    - Digital electronically registered crypto bearer bonds ("electronic crypto bonds" or "ECBs")
  - Introduce digital electronically register stock corporation shares at a later point in time

Eligible Securities

- EFUs
  - Bearer fund units which represent a certain fraction in a segregated investment fund („*Sondervermögen*“) may be issued as EFUs (§ 95 para. 1 sentence 1 German Capital Investment Fund Act)
- EBs
  - Bearer bonds under §§ 793ff. German Civil Code („*Inhaberschuldverschreibungen*“) may be issued as EBs (§§ 1, 4 para. 2 ESA)
    = so-called Centrally Registered Securities („*Zentralregisterwertpapiere*“)

Eligible Securities (cont'd)

- This covers, among other things,
  - Corporate and sovereign plain vanilla bonds
  - Commercial paper
  - Covered bonds
  - Exchangables and warrants
  - Structured notes (including credit-linked notes)
  - AT1 Notes and Tier2 Notes and any other subordinated notes
- ECBs (see above) (§§ 1, 4 para. 3 ESA) = so-called Crypto Securities („*Kryptowertpapiere*")

Ineligible Securities

- The following types of securities are currently not eligible:
  - Stock corporation shares
  - Investment fund shares (other than EFUs)
  - Registered bonds („*Namensschuldverschreibungen*“)
  - Bonds transferable by way of endorsement („*Orderschuldverschreibungen*“)
  - Bearer bonds not governed by German law
  - Certificates of indebtedness („*Schuldscheine*“) and other tradeable payment receivables

Grandfathering

- Grandfathering is available for the following pre-existing legacy instruments, i.e. existing securities can be transformed into EBs, EFUs or ECBs:
  - Bearer bonds, provided they will be registered (i) in a central electronic register operated by a CSD, and (ii) in the name of a CSD, and (iii) terms and conditions of the bonds do not exclude the transformation (§ 33 ESA in conjunction with § 6 para. 3 ESA): no investor consent required.
  - Bearer fund units, representing a fraction of a segregated investment fund (§ 95 para. 3 German Capital Investment Funds Act in conjunction with § 33 ESA): no investor consent required.
  - Security token, provided all registration steps required by the ESA can be performed (see: official reasoning of § 33 of the Government Draft Act): 100% investor consent is required.

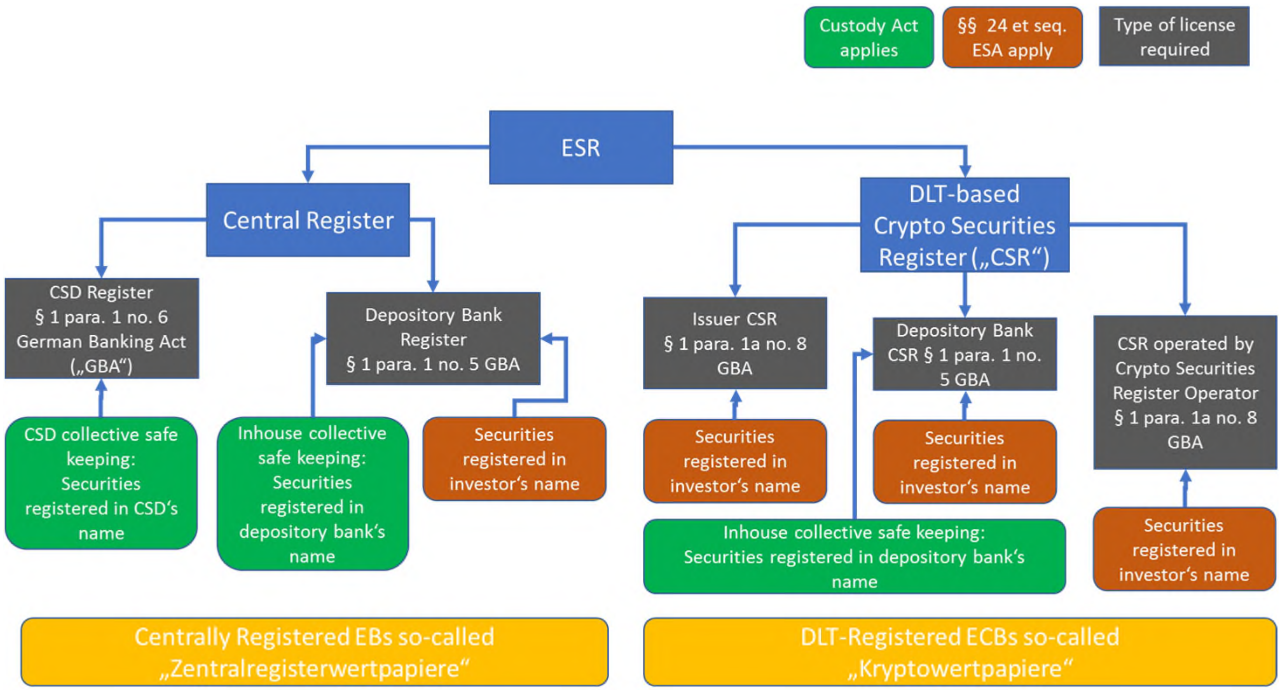
Optionality and Registration Requirement

- The issuance of digital securities is optional (§ 2 para. 1 ESA); definitive (global) certificates may still be issued, but can be transformed at any time pursuant to § 6 ESA:
  - No consent requirement, provided bonds will be registered (i) in a central electronic register operated by a CSD, and (ii) in the name of a CSD, and (iii) terms and conditions of the bonds do not exclude the transformation (§ 6 para. 3 ESA)
  - Full consent requirement for all other bonds (§ 6 para. 4 ESA)

Optionality and Registration Requirement (cont'd)

- The issuance of digital securities requires their registration in an electronic securities register ("ESR") (§ 2 para. 1 sentence 2 ESA), i.e.
  - Central Register („*Zentrales Register*") (§§ 4 para. 1 no. 1, 12 para. 1 ESA)
  - Crypto Securities Register („*Kryptowertpapierregister*") (§§ 4 para. 1 no. 2, 16 para. 1 ESA)
- Please note, that electronic securities – once registered – are legally treated as if they were moveable chattel ("Sachen") pursuant to § 2 para. 3 ESA
- As a consequence, any rights in relation to an electronic security are *in rem* rights, i.e. property rights

Available types of ESRs



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Primary Market: Creation Process

- Step 1: Conclusion of Dealer Agreement, Bond Purchase Agreement, Registration Agreement, etc.
- Step 2: Conclusion of mandatory bi-lateral Negotiation Agreement („*Begebungsvertrag*")
- Step 3: Deposition („*Niederlegung*") of Terms and Conditions of the Issue prior to registration (§ 5 para. 1 ESA)
- Step 4: Filing of registration documentation, which needs to comply with § 13 para. 1 and 2 ESA or § 17 para. 1 and 2 ESA, as the case may be

Primary Market: Creation Process (cont'd)

- Step 5: Registration of securities in chosen ESR (§ 4 para. 3 ESA), whereby digital securities are legally created (§ 2 para. 1 ESA)
- Step 6: Only in case of ECBs, publication in the Federal Gazette (§ 20 ESA) and delivery of register extract to registered holder (§ 19 ESA)

Primary Market: Filing Requirements

- The following mandatory filing requirements must be observed:
  - ISIN/WKN (§§ 13 para. 1 no. 1, 17 para. 1 no. 1 ESA)
  - List of material features (§§ 13 para. 1 no. 1, 17 para. 1 no. 1 ESA)
  - Aggregate nominal value or number of securities (§§ 13 para. 1 no.2, 17 para. 1 no. 2 ESA)
  - Nominal value, if applicable (§§ 13 para. 1 no. 3, 17 para. 1 no. 3 ESA)
  - Name of issuer (§§ 13 para. 1 no. 4, 17 para. 1 no. 4 ESA)
  - Type of issue, i.e. individual bond or global issue divided in fungible bonds (§§ 13 para. 1 no. 5, 17 para. 5 no. 1 ESA)

Primary Market: Filing Requirements (cont'd)

- Registered holder or registered nominee (§§ 13 para. 1 no. 6, 17 para. 1 no. 6 ESA)
- Clear and unambiguous reference to deposited terms and conditions (§ 4 para. 4 ESA)
- In case of individual bonds additionally:
  - Any transfer restrictions (§§ 13 para. 2 no. 1, 17 para. 2 no. 1 ESA)
  - Any encumbrances and other rights of third parties (§§ 13 para. 2 no. 2, 17 para. 2 no. 2 ESA)

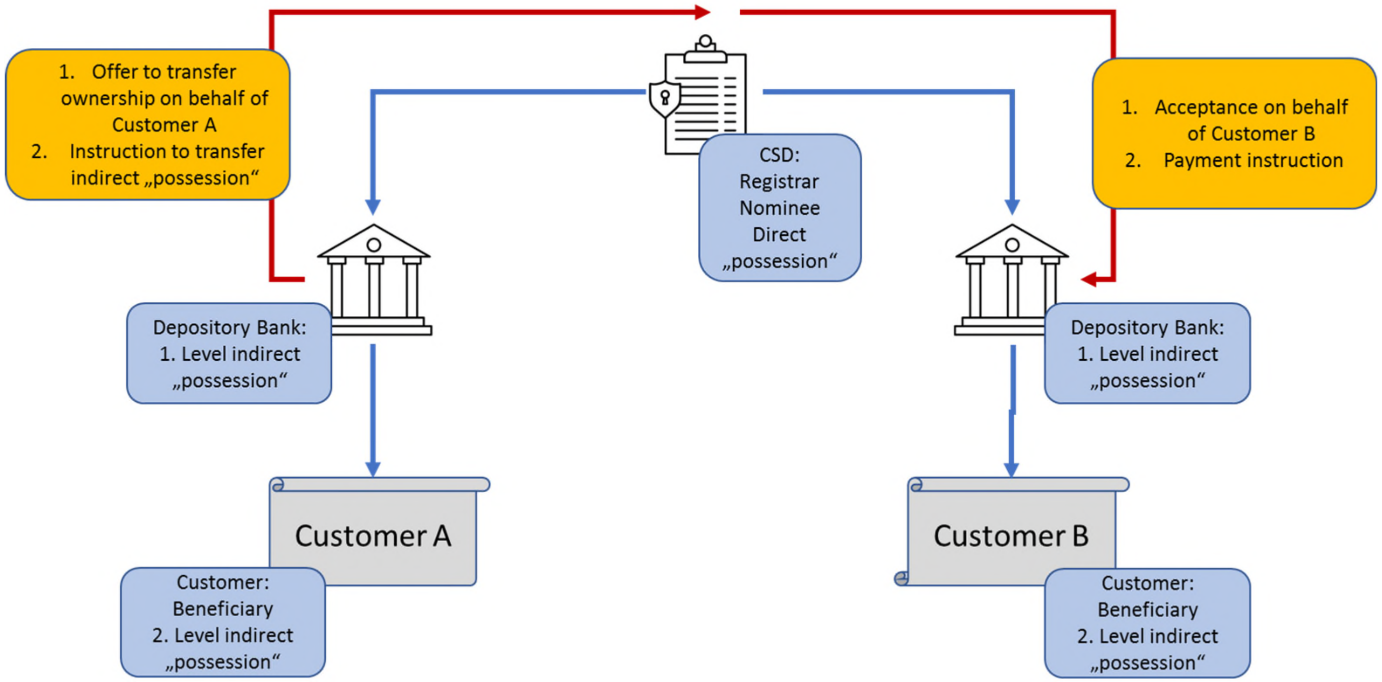
Secondary Market: Transfer of Ownership in Central Register (Collective Safe Keeping)

- CSD is nominee holder of the EBs (§§ 8 para. 1 no. 1, 9 para. 2 ESA) and holds direct "possession" of the EBs.
- Beneficiaries hold fractional co-ownership interest (§ 9 para. 1 ESA) and indirect possession, which are not recorded in the Central Register, but are solely recorded in the security accounts maintained with the depository banks.
- Transfer of ownership is effected outside of the Central Register under § 929 sentence 1 German Civil Code and requires:
  - Agreement among Customer A and Customer B that title shall pass, and
  - Transfer of indirect possession from Customer A to Customer B

Secondary Market: Transfer of Ownership in Central Register (Collective Safe Keeping) (cont'd)

- The necessary instructions and declarations are made by Depository Bank A on behalf of Customer A and are accepted by Depository Bank B on behalf of Customer B.
- The instructions and declarations are channeled through, and passed on by, the CSD Acquisition of title by bona-fide purchaser for value is possible (§§ 932 et seq. German Civil Code)

Secondary Market: Transfer of Ownership



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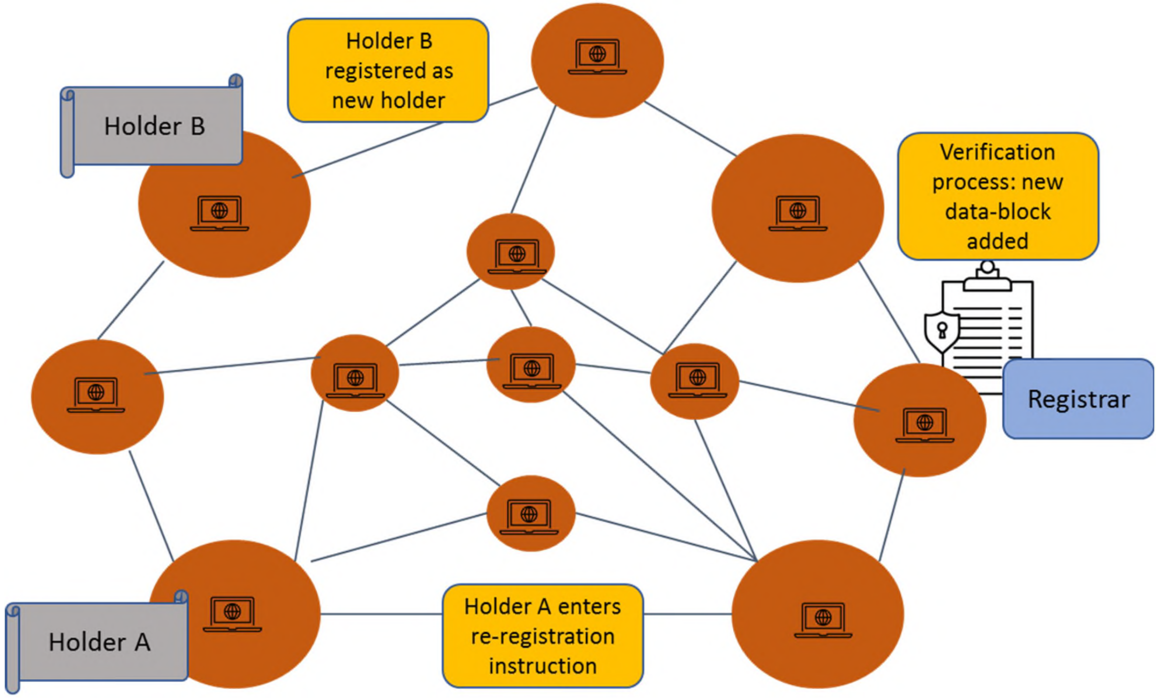
Secondary Market: Transfer of Ownership in Crypto Securities Register

- Registered person is direct holder and owner of the ECB (§§ 3 para. 1, 27 ESA) and holds direct “possession“ of the ECB.
- Transfer of ownership is effected directly in the register under § 25 para. 1 ESA and requires:
  - Agreement among Holder A and Holder B that title shall pass, and
  - Instruction from Holder A that Holder B shall be registered as the new holder and owner of ECB
- The necessary instructions and declarations are made by Holder A by entering these instructions and declarations into the system, using his public and private key

Secondary Market: Transfer of Ownership in Crypto Securities Register (cont'd)

- The instructions and declarations are channeled through the system, authenticated and ultimately passed on to Holder B.
- If the instructions are verified in the system (§ 18 para. 1 no. 1 ESA), a new data-bock is added representing Holder B's registration as new holder of ECB, and at that moment title passes from Holder A to Holder B (§ 25 para. 1 sentence 2, para. 2 ESA).
- Acquisition of title by bona-fide purchaser for value is possible (§ 26 ESA).
- No transfer of ownership, creation of an encumbrance or of any other third-party right can be effected outside of the register (§ 24 ESA).

Secondary Market: Transfer of Ownership in Crypto Securities Register



Operational Requirements

- Registrar must procure that the confidentiality, integrity and authenticity of data is ensured at any time (§ 7 para. 1 ESA).
- In case of a crypto securities register the registration system must be a decentralized, distributed system, were read and write authorities, control and verification processes must be clearly predetermined (§ 4 para. 11 ESA).
- Registrar must have state-of-the-art protections against unauthorized access, modification, loss or deletion of data records (§§ 7 para. 3, 16 para. 1 ESA).
- Registrar must procure that the essential features and legal rights in respect of the registered EBs or ECBs are properly and completely recorded and represented by the register at any time (§§ 7 para. 2, 13 para. 1, 17 para.1 ESA).

Operational Requirements (cont'd)

- Any changes to the register may only be made, if they have been instructed by an authorized person (§§ 14 para. 1, 18 para. 1 ESA), and any instructions must be assigned with a time-stamp and can only be processed sequentially in the order of these time-stamps (§§ 14 para. 1 sentence 3, para. 3, 18 para. 1 sentence 3, para. 3 ESA).
- In case of ECBs, the issuer must ensure that all operational and technical requirements, which affect the integrity and authenticity of the ECBs, are complied with by the registrar; in the event that this cannot be ensured, the issuer must move all the ECBs to another register (§§ 21, 22 ESA).

Liability Issues

- The registrar is fully liable for any damages resulting from a negligent failure to ensure that the essential features and legal rights in respect of the registered EBs or ECBs are properly and completely recorded and represented by the register at any time; the burden of proof for the absence of negligence lies with the registrar (§ 7 para. 2 ESA).
- The registrar is fully responsible by way of strict liability for any damages resulting from an unauthorized access, modification, loss or deletion of data records (§ 7 para. 3 ESA).
- The issuer of ECBs is fully responsible by way of vicarious liability, if he fails to ensure that technical or operational issues affecting the integrity and authenticity of the ECBs are not remedied (§ 21 ESA); furthermore, this qualifies as an event of default giving rise to a right of acceleration (§ 30 ESA).

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Frankfurt
Friedrich-Ebert-Anlage 35-37
60327 Frankfurt am Main
Germany
T: +49 69 79 41 0
F: +49 69 79 41 100

London
201 Bishopsgate
London EC2M 3AF
United Kingdom
T: +44 20 3130 3000
F: +44 20 3130 3001

New York
1221 Avenue of the Americas
New York, NY 10020-1001
USA
T: +1 212 506 2500
F: +1 212 262 1910

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