

BREXIT AND CAPITAL MARKETS - CONSIDERATIONS FOR A "NO DEAL" BREXIT

29 March 2019 (the proposed "Brexit date") is looming, yet there is still no decision on whether the UK will enter into a transitional arrangement with the EU or leave with no deal.

This briefing highlights some key questions to consider should the UK cease to be an EEA country on 29 March 2019 without any transitional or special arrangements.

1. London Stock Exchange - loss of EEA regulated market ("RM") status

A key area of focus for Eurobond markets and Brexit has been the London Stock Exchange's Main Market. If the UK is no longer an EEA country after 29 March 2019, the Main Market will no longer qualify as an EEA RM.

For some issuers and investors, loss of EEA RM status will be of no concern. For others, though, loss of EEA RM status will have implications – notably, those for whom eligibility of debt securities as ECB collateral is key.

There are also implications arising from the fact that the Main Market will fall outside the scope of the EU Prospectus Directive (2003/71/EC), as amended ("**EU PD**"), EU Transparency Directive (2004/109/EC), as amended ("**EU TD**") and other EU Directives and Regulations. These implications are discussed further in the paragraphs below.

2. Investor requirements for an EEA RM

The growth of listings on exchange-regulated markets in Europe (such as, the Professional Securities Market ("**PSM**") and the International Securities Market ("**ISM**"), in the UK, the Euro MTF in Luxembourg and the Global Exchange Market ("**GEM**") in Ireland) in recent years is testament to the fact that many investors no longer need or demand admission to trading on an EEA RM. For those issuers and investors, factors such as the reputation of the exchange or the availability of the quoted Eurobond exemption are the main criteria driving choice of exchange. That said, certain investors (such as UCITS funds) may still require that securities which they purchase (or a specified portion of securities in their portfolios) are admitted to trading on an EEA RM.

Key issues

- Potential loss of EEA RM status for the London Stock Exchange's Main Market
- ECB eligibility requirements will need to be assessed
- Determine whether passporting is a consideration for EEA public offers or admission to trading
- Select a new Transparency Directive Home Member State?
- Bank issuers: Consider Article 55 clauses
- Consider whether to adapt jurisdiction clauses from 1 April 2019, particularly in light of the Hague Convention on choice of courts

3. ECB eligible collateral

Eligibility as ECB collateral is often important to bolster demand for bonds and aid liquidity. Central bank eligibility is also one of the criteria relevant for assets to achieve High-Quality Liquid Asset ("**HQLA**") status under the EU Capital Requirements Regulation, in order that they are capable of forming part of a bank's liquidity coverage requirement ("**LCR**") to withstand stress scenarios.

a) Loss of EEA RM status: As an EEA RM, the London Stock Exchange's Main Market is currently one of the "acceptable markets" in the ECB's eligibility criteria. Post-Brexit, however, absent special arrangements, bonds admitted to trading on the London Stock Exchange's Main Market will no longer meet the ECB's admission to trading criteria.

To date, the ECB has given no indication of any special concessions or grandfathering arrangements with respect to the London Stock Exchange's Main Market. Accordingly, where ECB eligibility is important for issuers and investors, we may see a switch away from UK listing and admission to trading and a move elsewhere. Both the UK's "non-regulated" or "exchange-regulated" markets, the PSM and ISM, are not currently acceptable markets for the ECB, unlike, for example, Luxembourg's Euro MTF or Ireland's GEM. Where ECB eligibility will be important, passporting a PD-compliant base prospectus into another (non-UK) EEA jurisdiction to enable a secondary listing on an EEA RM, or seeking a secondary admission to an acceptable exchange-regulated market, would be a precautionary step for those updating their EMTN programmes before 29 March 2019 (although an EEA RM listing will also be subject to the approach taken by EEA competent authorities to base prospectuses which "span" the proposed Brexit date, as described under "EU Prospectus Directive regime" below).

b) Sterling: Currently, GBP is an eligible temporary currency under ECB Guidelines (along with US Dollars and Japanese Yen). It is unclear whether that will change post-Brexit and whether bonds denominated in GBP will cease to be eligible.

c) UK issuers: Euro-denominated bonds issued by G10 and EEA issuers are eligible under the criteria for ECB collateral, yet eligibility of the "temporary" currencies of USD, GBP and Yen is restricted to EEA issuers only.

Absent special concessions, if the UK is no longer an EEA country, UK issuers will no longer be able to have bonds they issue denominated in GBP, USD or Japanese Yen accepted as eligible. Again, the question of grandfathering for any existing bonds will also be relevant.

4. EU Prospectus Directive regime

a) UK implementation:

EU PD: In the event of "no deal", the UK Parliament would bring the current EU PD provisions into UK law after 29 March 2019 by transposing the prospectus regime and listing rules, with a few consequential changes. In December 2018, as part of its "no deal" Brexit contingency planning, the UK Government published draft legislation to achieve this and an explanatory memorandum.

PD3: In addition, looking further forward, the UK Government has indicated that it intends to honour the provisions of Regulation (EU) 2017/1129 ("**PD3**")

taking effect on 21 July 2019 which will replace the current EU PD regime. This is addressed along with other so-called "in-flight" EU laws (approved and in force prior to 29 March 2019 but which will take effect after Brexit day) dealt with in the contingency planning legislation.

As a result, the UK listing regime and public offer regime in the event of a "no deal" Brexit would largely replicate the current regime. It would, though, become a purely domestic regime and the UK and UK competent authority (the UK FCA) would fall outside the scope of the EU PD regime and future PD3 regime unless special arrangements are made. This would be most relevant in the context of passporting.

b) Passporting: Passporting is one of the key features of the EU PD regime. It allows a prospectus approved by a competent authority in one EEA jurisdiction to be used to make a public offer or to admit to trading on a regulated market in another. This is because there is a uniform prospectus disclosure regime applying for public offers and admission to trading in all EEA states.

If the UK is no longer within the EEA after 29 March 2019, it will become a "third country" and the UK FCA will become a "third country" authority. Prospectuses approved by the UK FCA after the Brexit date will therefore no longer be able to take advantage of EU PD passporting unless special arrangements are forthcoming. Moreover, given that the EU PD regime provides that an EU PD regime prospectus is valid for a period of up to twelve months after approval, an added question is how prospectuses which "span" 29 March 2019 will be treated.

UK approach - passporting in: The draft UK legislation and explanatory memorandum contain two significant features which are relevant for passporting after Brexit day: first, that the UK FCA would continue to accept prospectuses approved by other EEA competent authorities prior to 29 March 2019 for the remainder of the prospectuses' 12-month "life", as well as any supplements; and, secondly, that it will also continue to accept EU IFRS.

EU approach - passporting out: For prospectuses or base prospectuses approved by the UK FCA prior to 29 March 2019, neither the European Commission nor ESMA have yet given guidance on whether they will still be treated by EEA competent authorities as valid for the remainder for the 12-month period after approval.

Having said that, the majority of EU PD-compliant prospectuses are for eurobonds with "wholesale" denominations (that is, Euro 100,000 or equivalent or above). For those issuers, loss of passporting will be irrelevant (other than in the rare instance of seeking a dual listing in another EEA jurisdiction) because there is a public offer exemption under the PD for wholesale debt.

Absent special arrangements, issuers of "retail" debt (that is, denominations of less than Euro 100,000 or equivalent) will no longer be able automatically to "passport" a prospectus approved by the UK FCA. Instead, issuers who have a prospectus approved by the UK FCA may need a separate, independent prospectus approval by another EEA competent authority before being able to make a public offer in EEA jurisdictions or to admit securities to trading on an EEA RM. The likely result is that issuers for whom the facility of passporting and public offers is important will consider switching the approval of the prospectus to other European competent authorities.

c) UK issuers: There are two extra EU PD considerations for UK issuers:

Issuers of low denomination debt (less than Euro 1,000) and equity: UK issuers will become "third country" issuers falling within the final limb of the

"Home Member State" ("**EU PD HMS**") definition within the EU PD. Absent special arrangements, in the same way as other "third country" issuers, they will have a limited choice of EU PD HMS to approve an EU PD-compliant prospectus, based on where they first had securities admitted to trading or made a public offer. As the relevant date of that first offer or admission is unclear (should it be 2003 (when the PD first came into force) or post-Brexit?) issuers will need to be careful after 29 March 2019.

UK GAAP: For those UK issuers who continue to use UK GAAP, there may also be a technical issue relating to financial disclosure requirements unless UK GAAP is determined to be equivalent to EU IFRS for the purposes of the EU PD. If the UK is no longer a Member State, the two options permitted under disclosure Annexes I, IV and IX (for equity, retail debt and wholesale debt) are either IFRS or third country national accounting standards determined to be equivalent. At present, no such equivalence determination has been made. Under the UK domestic regime, however, the draft implementing SI makes specific changes to permit the use of UK GAAP in connection with UK FCA-approved prospectuses after the Brexit date.

5. EU Transparency Directive: Home Member State

As with the EU PD, the current transparency rules which apply in the UK and which derive from the EU TD will be transposed into English law on the Brexit date through secondary UK legislation in order to create a domestic regime in the UK. Issuers who had selected the UK FCA as competent authority for EU TD purposes will also need to consider selecting a new Home Member State for EU TD purposes ("**TD HMS**") and for on-going filings.

The definition of Home Member State under the EU TD allows an issuer (other than an issuer of equity and low denomination securities, as noted above) to select a Home Member State from the jurisdictions of the EEA RM on which their securities are admitted to trading or (if applicable) the Member State of their registered office. Again, UK issuers will no longer qualify as Member State issuers in a "no deal" scenario.

6. Additional considerations impacting parties, documentation and behaviour

a) Parties - "Third country" regimes and entities: Several EU Directives and Regulations impose additional registration, equivalence and other criteria on third country regimes and entities. Examples include the EU Statutory Audit Directive and the EU Benchmark Regulation. Due consideration will therefore need to be given to whether UK auditors, credit rating agencies, benchmark administrators and other entities will need to take additional steps in order to be able to continue to act on bond issues. Similarly, consideration will need to be given to EU sanctions provisions and anti-boycott provisions referenced in contracts to assess possible changed scope in respect of the UK and UK entities.

b) Documentation - Bank Capital - Article 55, BRRD: Absent equivalence arrangements, banks may need to include contractual recognition of bail-in language (known as Article 55 BRRD text) in English law bond terms; both in MREL-eligible instruments and non-MREL liabilities that might be subject to bail-in as part of a resolution action. This could therefore encompass other English law contracts such as subscription and agency agreements, as is currently the case for New York law obligations.

c) Documentation – references to EEA and EEA retail investors: The standard capital markets legending and selling restrictions which refer to

public offers and sales within the EEA (such as EU PD selling restrictions) or which prohibit sales to EEA retail investors (such as, PRIIPs and MiFID 2 legending) will need to be adjusted to reflect that fact that the UK is a "third country" and therefore no longer within the scope of the current legending or restrictions.

d) Documentation - Jurisdiction clauses: Our recent briefing on jurisdiction clauses and Brexit (January 2019 "*Brexit and choice of courts: UK accedes to the Hague Convention*") indicates that consideration may need to be given to adapting jurisdiction clauses in contracts after 1 April 2019 to facilitate enforceability of judgments in EU Member States in a "no deal" Brexit scenario – notably, a possible trend towards exclusive jurisdiction clauses following the UK's tentative accession to the Hague Convention on choice of courts agreements (which provides for mutual recognition and enforcement of judgments between contracting States, including EU Member States, where the jurisdiction is taken on the basis of an exclusive jurisdiction agreement).

e) Behaviour - EU Market Abuse Regime: The UK will transpose the current EU Market Abuse Regulation 596/2014 ("**MAR**") rules as at 29 March 2019 creating a parallel domestic regime. In some circumstances, such as where there is a primary and secondary listing, this may result in dual regulatory authorities (the UK FCA and a national regulatory authority in the EEA) and duplicate filings.

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