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

The possibility of a No Deal Brexit on 31 October still looms. This briefing highlights some key questions to consider should the UK cease to be an EEA country on 1 November 2019 without transitional or special arrangements.

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 and contractual stay**
- **Consider whether to adapt jurisdiction clauses, particularly in light of the Hague Convention**

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 31 October 2019, the Main Market will no longer qualify as an EEA RM. For some issuers and investors, the changed 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 regime under Regulation (EU) 2017/1129 ("EU **PD3"**), the 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.

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 and, to date, the ECB has given no indication that there will be any special concessions or grandfathering arrangements once it ceases to be an EEA RM. To try to address this concern, the London Stock Exchange took steps outlined in its 1 April 2019 paper "*London Stock Exchange plc Hard Brexit guidance and contingency planning for qualification of bonds as ECB eligible collateral*", whereby a bond listing on the Main Market is automatically admitted to trading on MTS BondVision Europe in Milan, an MTF which is currently one of the “acceptable non-regulated markets” of the ECB. This may well remain a "wait and see" scenario – not only with regard to ECB criteria, but also whether the admission on the Italian MTF will expose the issuer to additional EU Market Abuse Regulation ("**MAR**") obligations.

b) Pounds 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: 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 therefore no longer be able to have bonds they issue denominated in GBP, USD or Japanese Yen accepted as eligible. The question of grandfathering for any existing bonds will also be relevant.

In addition, for UK banks or investment firms, there is an additional consideration. Article 81a in the ECB's rules, which took effect in April 2018 (with limited grandfathering), restricts eligibility for unsecured bank bonds (or "UBBs") to EU issuers only.

d) UK guarantors: Under the ECB criteria, guarantors must be EEA and have EEA governing law. Accordingly, bonds with UK guarantors may not meet the ECB eligibility criteria unless an exception is available.

4. EU Prospectus regime

a) UK implementation:

EU PD3: The UK listing regime and public offer regime in the event of a "no deal" Brexit will largely replicate the current EU PD3 regime which took effect across the EEA from 21 July 2019. (The UK "onshoring" required two separate UK SIs. This was due to the fact that EU PD3, which replaced the former EU regime (commonly referred to as "**PD2**") in full, took effect after 29 March 2019, the date originally envisaged for Exit Day before the extension, requiring further adjustments.)

Following a No Deal Brexit, the UK prospectus regime will become purely domestic and the UK and UK competent authority (the UK FCA) will fall outside the scope of the PD3 regime unless special arrangements are made. This would be most relevant in the context of passporting of prospectuses.

b) Passporting: Passporting is one of the key features of the EU prospectus 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 no longer falls within the EEA after 31 October 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 passporting unless special arrangements are forthcoming in the future.

What about prospectuses which "span" 31 October 2019 and still have some of their 12-month life to run? The UK and EEA are taking differing approaches:

UK approach - passporting in: The UK FCA will continue to accept prospectuses approved by other EEA competent authorities prior to 31 October 2019 (whether approved under PD2 or PD3) for the remainder of the prospectuses' 12-month "life". There appears to be a distinction with regard to treatment of supplements, however: those supplementing a PD2 prospectus are able to be approved by an EEA competent authority and notified to the UK FCA; for supplements to the (relatively few) PD3 prospectuses passported into the UK since 21 July 2019, the UK FCA is to be the competent authority. Additionally, the UK will continue to accept EU IFRS.

EU approach - passporting out: In contrast, prospectuses or base prospectuses approved by the UK FCA prior to 31 October 2019 will cease to be valid for offers or admission in the EEA after that date. An ESMA special "Brexit" Q&A indicated that issuers would 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. Having said that, the majority of EU prospectus regime 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.

c) UK issuers: There are two extra EU PD3 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 PD3 HMS**") definition within the EU PD3 regime. Absent special arrangements, in the same way as other "third country" issuers, they will have a limited choice of EU PD3 HMS to approve an EU PD3-compliant prospectus, based on where they first had securities admitted to trading or made a public offer.

UK IFRS and UK GAAP: UK issuers wishing to make use of the EU PD3 prospectus regime after 31 October 2019 may face technical issues, pending equivalence determinations for UK IFRS (that is, EU-adopted IFRS on-shored and "frozen" on Exit Day) or UK GAAP. That is because PD3 disclosure Annexes mandate EU IFRS or third country national accounting standards determined to be equivalent. In contrast, in respect of the UK, HMT has stated that it intends to issue an equivalence statement before Exit Day to allow EEA issuers to continue to use EU-adopted IFRS for prospectuses for securities admitted to trading on a regulated market in the UK or for making an offer of securities in the UK.

5. EU Transparency Directive: Home Member State

As with the EU prospectus regime, current transparency rules which apply in the UK and which derive from the EU TD will be transposed into English law through secondary UK legislation to create a domestic regime in the UK on the Brexit date. 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. 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 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 for the UK and UK entities.

b) Documentation - Bank Capital - Article 55, BRRD and contractual stay: Absent equivalence arrangements, EEA banks may need to include contractual recognition of bail-in language (known as Article 55 BRRD text) and contractual stay in English law bond terms - both in MREL-eligible instruments and non-MREL liabilities – and other English law contracts such as subscription and agency agreements, as is currently the case for New York law and other third country law obligations. For UK entities, the UK PRA has indicated that such clauses should be included in relevant new EEA law contracts, but will not be generally be requiring amendments to contracts entered into before Exit Day.

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 or which prohibit sales to EEA retail investors 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 provisions.

d) Documentation - Jurisdiction clauses: Our January 2019 briefing on jurisdiction clauses and Brexit ("*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 Exit Day 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 31 October 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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