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Brexit Law – your business, the EU and the way ahead

Preparing for a no-deal Brexit – ten points relevant to mainstream debt capital market issuance

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The current political landscape means that uncertainty as to the nature of the UK's withdrawal from the EU continues. It remains a possibility that the UK will leave the EU on 31 October 2019 without a deal – a so-called "no-deal Brexit". A no-deal Brexit will mean that the UK will not be a Member State of the EU and that Union law will not be applicable in the UK.

In light of this (and as an update to our previous publication dated February 2019), we set out below a high-level discussion of ten points for action and issues for consideration to assist issuers and other participants in the mainstream debt capital markets in preparing for a no-deal Brexit. The UK Government has announced, and UK exit legislation provides for, measures which will address some concerns of issuers accessing UK markets following a no-deal Brexit. We have not seen any similar measures in the areas covered below contemplated by the EU to date. Therefore, our points below focus principally on the impact of a no-deal Brexit on accessing EU27 markets and complying with EU27 regimes post-Brexit. We do not cover in detail the UK domesticated regime post-Brexit, but if you would like general information in relation to the European Union (Withdrawal) Act 2018 and the legislative position in the UK post-Brexit, please refer to other Brexit publications on our website. Finally, while many of the points below will apply equally in relation to covered bond and structured finance transactions in general, there will also be additional points to consider in those contexts which we do not cover in this paper.

1. London listed bonds should continue to be potentially eligible as collateral in Eurosystem operations

Assets that are to be used as collateral in Eurosystem credit operations must fulfil certain specified criteria. For debt instruments to be eligible, one of the criteria to be met is that they must be admitted to trading on an EU regulated market or on an acceptable non-regulated market. Following a no-deal Brexit, the main market of the London Stock Exchange will no longer be an EU regulated market. It is also uncertain whether the European Central Bank (**ECB**) will revise its list of acceptable non-regulated markets to include London's main market.

However, in April this year the London Stock Exchange confirmed in a document published on its website (LSE Hard Brexit ECB eligible collateral note) that, going forward, MTS BondVision Europe MTF (previously BondVision SSO)(**MTS**) - which is part of the London Stock Exchange Group and is on the ECB's list of acceptable non-regulated markets - will admit to trading London listed bonds that satisfy MTS's admission criteria. We understand that this is an automatic procedure which should not result in additional obligations or costs for issuers. The London Stock Exchange also indicated in April this year that London listed bonds which were on the ECB's list of eligible marketable assets would be added automatically to MTS, provided they satisfied MTS's admission criteria. These moves represent a welcome initiative by the London Stock Exchange which should enable certain London listed bonds to meet the ECB "acceptable markets" criterion.

2. Issuers with FCA approved prospectuses used in EU27 to consider funding needs and prospectus approval

On a no-deal Brexit, the ability to passport a prospectus between the UK and EU27[1] under the EU prospectus regime will end. As initially confirmed by the UK Government, relevant UK exit regulations provide that prospectuses approved by an EU27 competent authority (whether under the EU Prospectus Regulation or, in the case of those approved prior to 21 July, under the EU Prospectus Directive) and passported into the UK before Brexit will be grandfathered for use in the UK until their validity expires. However, the European Securities and Markets Authority (**ESMA**) has not provided a similar confirmation in respect of an FCA approved prospectus passported into the EU prior to Brexit. In a revised version of its Q&A on Prospectuses, updated in April, ESMA confirmed that prospectuses approved by the FCA and passported to the EU27 before the UK's withdrawal cannot be used to either offer securities to the public on a non-exempt basis, or admit securities to trading on a regulated market, within the EU27 following a no-deal Brexit.

Following a no-deal Brexit, therefore, issuers wishing to admit to trading on a regulated market in the EU27 or offer to the public in the EU27 on a non-exempt basis will need prospectus approval from an EU27 competent authority. Considering what action to take will be particularly relevant for issuers with FCA approved London listed retail programmes, who will be keen to protect their ability to issue seamlessly post-Brexit. They should consider whether their funding needs still require them to offer on a non-exempt basis across the EU27; if so, they should factor in the need to seek approval of the base prospectus from an EU27 competent authority for that purpose. Many other considerations will also impact an issuer's decision, such as whether a London listing and access to the UK's markets will still be important.

3. Check value of sterling when setting denomination

Where an issuer issues "wholesale denomination securities" – that is, debt securities having a denomination of at least EUR100,000 or equivalent in another currency – it takes the benefit of key exemptions from certain obligations under both the EU's prospectus and transparency regimes. The "wholesale" regime benefits include lighter prospectus disclosure requirements, a summary exemption, an exemption for offers to the public and an exemption from the EU Transparency Directive's financial reporting requirements.

It is not clear exactly what the impact of a no-deal Brexit will be on the value of sterling. Therefore, issuers of sterling-denominated debt securities which rely on their denomination for the purposes of the "wholesale" regime should check when issuing that the denomination of their securities is equivalent to EUR100,000. This may entail setting denominations at GBP200,000, should sterling fall significantly against the euro, and would also mean that issuers are unable to tap issues with a GBP100,000 denomination (as a different denomination will affect fungibility). A similar point

[1] References to the EU27 can be read as including the three EEA States, Norway, Iceland and Liechtenstein.

will be relevant for any issuers of sterling-denominated securities who will continue to access EU27 markets following a no-deal Brexit and wish to have choice over which competent authority will approve their prospectus – it will be important to ensure that the debt securities have a denomination equivalent to at least EUR1,000. EUR100,000 (or equivalent in another currency) will also be the relevant denomination threshold for "wholesale" treatment under the UK's domestic prospectus regime post-Brexit, so checking the value of sterling will also be prudent from that perspective.

4. Issuers with the UK as TD home Member State may need to choose again

The EU's Transparency Directive (**TD**) regime requires filing, publication and dissemination of "regulated information" with an issuer's home Member State. Certain issuers currently have the UK as their TD home Member State. Whilst UK domestic rules will be relevant for issuers with London listed securities following a no-deal Brexit (from a domestic transparency and continuing obligations perspective), issuers with debt securities listed elsewhere in the EU27 will need to elect another home Member State in place of the UK to satisfy EU27 transparency requirements. ESMA has confirmed this in a revised version of its Q&A on the Transparency Directive, updated in April, noting that affected issuers must make their home Member State determination according to Article 2(1)(i) of the TD. ESMA also reminded issuers to disclose their home Member State choice in accordance with the TD; such choice and disclosure should be made without delay following the UK's withdrawal.

5. Selling restrictions and legends will need to be revisited

As mentioned above, a no-deal Brexit will mean that the UK will not be a Member State of the EU and that Union law will not be applicable in the UK. As a result, the current market standard ICMA EEA public offer selling restriction, which has been the subject of a recent updating exercise for the new EU Prospectus Regulation, will no longer cover the UK public offer regime and consideration will need to be given to how to address the UK position and relevant English domestic law. Whilst agreement was reached around the ICMA table earlier in the year as to appropriate changes to the (then Prospectus Directive based) public offer selling restriction, PRIIPs selling restrictions and legends, MiFID product governance legends and language, stabilisation clauses and announcement language and retail cascade wording, further consideration of the language is required given that, on exit day, the UK will now onshore the new EU Prospectus Regulation regime. We are involved in discussions around the ICMA table on the necessary changes to the standard language.

6. UK GAAP issuers listed in EU27 will have more onerous disclosure requirements and may wish to reconsider any EU27 listing of "retail" debt

Following a no-deal Brexit, issuers who publish accounts using UK GAAP will still be able to use them to meet the UK's domestic prospectus disclosure requirements. However, UK issuers using UK GAAP to list on EU27 regulated markets or offer to the public in the EU27 on a non-exempt basis will face more onerous disclosure requirements in their prospectuses. This is because, post-Brexit, they become third country issuers for EU prospectus regime purposes, and such issuers must disclose financial information prepared according to IFRS or national accounting standards equivalent to IFRS. As UK GAAP is not equivalent to IFRS (and it is currently not expected that the European Commission will issue a decision stating it to be equivalent in the short term) UK GAAP issuers will therefore need to restate to IFRS (if producing a "retail" prospectus) or produce a narrative statement of differences from IFRS accounting (if producing a "wholesale" prospectus).

However, UK GAAP issuers may not want to list further "retail" debt securities, or maintain their listing of such existing securities, on an EU27 regulated market post-Brexit. This is because, as third country issuers of "retail" debt, they will be required by the TD to file annual and semi-annual accounts in accordance with IFRS, unless an equivalence decision regarding UK GAAP is made by the European Commission.

7. Supporting legal opinion will be required if UK issuer debt instruments are to meet ECB eligibility criteria

Debt securities of a UK issuer will continue to be potentially eligible as collateral in Eurosystem credit operations post-Brexit. However, as the UK will be a non-EEA G10 country post-Brexit, debt securities issued by a UK issuer must be supported by a legal opinion in a form and substance acceptable to the ECB.

8. Contractual recognition of bail-in required in English law-governed contracts of EU27 banks

Most EU27 bank issuers have already moved to include contractual recognition of bail-in language (for Article 55 EU Bank Recovery and Resolution Directive purposes) in relevant English law-governed terms and conditions in anticipation of English law becoming a third country law post-Brexit. Following a no-deal Brexit, it will also become necessary for EU27 bank issuers, dealers/managers and agents to include contractual recognition language in their "other liabilities" governed by English law.

As a result, it will be necessary to include relevant language in, amongst other things, subscription agreements, confirmations for a trade, agency agreements (or agency side letters for a programme) and auditor arrangement letters at the point of issuance, and via programme agreements, agency agreements and auditor arrangement letters at update of a programme.

9. Review listing covenants to ensure flexibility going forward

Whilst issuer listing covenants should be reviewed in light of Brexit, it is unlikely that Brexit – and the fact that London's main market will not be an EU regulated market going forward – will cause an issuer to breach its listing covenants. This is on the basis that most listing covenants require an issuer to maintain the particular listing that has been sought on issue for its notes.

However, some listing covenants provide that listing can be obtained instead on another EU regulated market as an alternative to maintaining the particular listing sought on issue. This would preclude listing on London as an alternative to an EU regulated market listing. Going forward, it may be desirable to add a specific reference to London's main market as an additional alternative to an EU27 regulated market, to ensure appropriate flexibility.

10. Asymmetric (also known as hybrid) jurisdiction clauses continue to need consideration

For some years now, it has been difficult to assess accurately the risks involved in including asymmetric (also known as hybrid) jurisdiction clauses in documentation. This is because the approach that EU Member State courts will take to such clauses has not been tested in the majority of jurisdictions, there have been unhelpful decisions in some EU Member States as to the validity of such clauses and there is no authority from the Court of Justice of the EU.

Nevertheless, English court asymmetric clauses have continued, for a variety of reasons, to be the popular form of jurisdiction clause in mainstream debt capital markets documentation.

Although the position is not entirely clear, the risks involved in including such clauses appear to arise irrespective of Brexit. Therefore, post any no-deal Brexit, parties should continue to carry out a case by case analysis as to whether any asymmetric clause is appropriate. For further information you may wish to refer to our client publication "Brexit – English law and courts: should recent developments change your approach?" available here, or to related client publications on our website.

Conclusion

The current political landscape means that uncertainty as to the nature of the UK's withdrawal from the EU continues. If the UK Government is able to agree a new Brexit deal with the EU, and the UK Parliament is able to reach consensus on that (or the previous) Brexit deal, this would give debt capital market participants comfort that a no-deal Brexit will be avoided (assuming the ratification process goes smoothly). There will likely be fewer points for consideration in respect of any transitional period, although of course no-deal Brexit considerations may still be relevant at the end of any such period. Whilst uncertainty continues, consideration of the issues outlined above will be a priority.

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