BREXIT AND CAPITAL MARKETS - 31 DECEMBER 2020 CONSIDERATIONS

From 31 December 2020 (when the Brexit transition period ends), if there is no Brexit trade deal for financial services, no concessions and no equivalence determinations, the United Kingdom will be treated like any other "third country". This briefing highlights key implications. It is based on the situation envisaged in the current UK SIs prepared for such a No Deal contingency.

Key issues

- **Third country and London Stock Exchange's Main Market no longer EEA RM**
- **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 bail-in and contractual stay clauses**
- **Consider whether to adapt jurisdiction clauses, particularly in light of the Hague Convention**

1. Third country status and fact that London Stock Exchange's Main Market no longer an EEA regulated market ("RM")

Some issuers and investors will be unperturbed by the fact that the United Kingdom is no longer an EEA country (or classed as such) from 31 December 2020 and that London Stock Exchange's Main Market will therefore no longer qualify as an EEA RM. For other issuers and investors, the potential implications with regard to:

- eligibility of debt securities as ECB collateral;
- the EU prospectus regime under Regulation (EU) 2017/1129 ("**EU PD3"**) and the EU Transparency Directive (2004/109/EC) as amended ("**EU TD**"); and
- other EU Directives and Regulations,

will be relevant. These implications are discussed 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: If the London Stock Exchange's Main Market is no longer an EEA RM, the other way for admission to trading on the Main Market to qualify would be for the ECB to add it to its list of "acceptable markets". To date, the ECB has given no indication that it will do so (and none of the other UK markets are currently on this list). The ECB has also given no indication of whether there will be special concessions or grandfathering arrangements once the Main Market ceases to be an EEA RM.

To address this concern, the London Stock Exchange took steps 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 – as described in the 2 June 2020 London Stock Exchange factsheet "Brexit guidance and contingency planning for qualification of bonds as ECB eligible collateral". Whilst this seems largely to address the concern, there has (again) been no commentary from the ECB. Moreover, there are diverging views around whether admission on the Italian MTF will expose the issuer to additional EU Market Abuse Regulation ("**MAR**") obligations (albeit that, on 31 December 2020, the UK and EU regimes will be the same) because an issuer applying to the London Stock Exchange's Main Market will be aware that automatic admission to BondVision will follow, albeit an "automatic" process without recourse to the issuer.

There is no indication as yet as to whether any possible sale of MTS by the London Stock Exchange (discussed in this 31 July 2020 announcement) might impact this arrangement.

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

c) UK issuers: As a G10 entity, UK issuers will still meet the eligibility criteria for Euro-denominated debt. Eligibility for the "temporary" currencies of USD, GBP and Yen is narrower and is restricted to EEA issuers only. Absent special concessions, therefore, if the UK is a third country and no longer an EEA country (or treated as such), UK issuers will 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 and English law guarantees: Under the ECB criteria, guarantors must be EEA entities, if required for credit purposes. Significantly, though, under the ECB's criteria, where a bond issue has own rating (even

when relying on a guarantor's rating) the guarantee will not be deemed to be for credit purposes. In a similar vein, the governing law of a guarantee would only need to be EEA law if the guarantee is required for credit purposes. In other cases, English law would satisfy criteria.

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 its 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 December 2020, it will become a "third country" and the UK FCA will become a "third country" authority. Prospectuses approved by the UK FCA after 31 December 2020 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 December 2020 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 December 2020 for the remainder of the prospectuses' 12-month "life". For supplements to those prospectuses, however, 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 December 2020 will cease to be valid for offers or admission in the EEA after that date. An ESMA special "Brexit" Q&A (last updated on 11 April 2019) 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 in the EEA 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: During the Brexit transition period and for financial periods commencing prior to 31 December 2020, UK companies continued to use EU-adopted IFRS or UK GAAP. Initially, therefore, for historic information required to meet PD3 Annex disclose requirements there will be no change for UK issuers.

On 31 December 2020, EU IFRS Standards will be "frozen" and on-shored into UK domestic law creating UK IFRS Standards. UK companies will need to adhere to UK IFRS Standards or UK GAAP for financial years beginning after that date. As a practical matter, UK IFRS will initially be identical to EU IFRS until divergence, but, technically, in order to use UK IFRS to meet PD3 requirements without restatement or a narrative of differences, it will need to be determined to be "equivalent" (that is, either IFRS where the notes to the audited financial statements contain an explicit and unreserved statement that these financial statements comply with international financial reporting standards in accordance with IAS 1 or a specific EU determination of equivalence (as is currently the case for Canadian, Chinese, Japanese, Korean and U.S. GAAP)).

HM Treasury issued Directions in April and October 2019 regarding equivalence of EU IFRS for the purpose of the Prospectus Regulation and Transparency Directive, but no such indications have yet been forthcoming from the EU.

The question of GAAP equivalence is also relevant for Transparency Directive filings.

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 31 December 2020. 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 at the end of the Brexit transition period.

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 - bail-in and contractual stay: Absent equivalence arrangements, EEA banks may need to include contractual recognition of bail-in language (addressing Article 55 BRRD text) and contractual stay (addressing Article 71a BRRD2) in English law contracts, as is currently the case for New York law and other third country law obligations. In a bond context, Article 55 BRRD will be a consideration for English law bond terms - both in MREL-eligible instruments and non-MREL liabilities – as well as for other documentation such as subscription and agency agreements; Article 71a BRRD2 will be of more limited application.

For UK entities, proposed changes to the PRA Rulebook (see CP13/20 and the draft "PRA Rulebook: Exit Instrument 2020" dated 22 September 2020, Annex O) would require contractual recognition of bail-in clauses to be included in relevant new EEA law contracts entered into after 31 December 2020 or materially amended after that date. These are, however, subject to proposed transitional provisions which, if adopted, would exempt contracts other than bonds until March 2022. Contractual recognition of stay under Article 71a is one of the BRRD2 amendments due to apply from 28 December 2020 (three days before the end of the Brexit transition period). As described in CP13/20, BRRD2 changes will be transposed in the UK and implemented in the UK PRA Rulebook following consultation.

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. Additional UK-specific legends may also be required to reflect the on-shored regime.

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 to facilitate enforceability of judgments in EU Member States in a No Deal scenario – notably, a possible trend towards exclusive jurisdiction clauses. The Hague Convention provides for mutual recognition and enforcement of judgments between contracting States, including EU Member States for a contract with an exclusive jurisdiction clause. On 28 September, with the intention of ensuring continuity of application of the Hague Convention, the United Kingdom submitted an Instrument of Accession under the Hague Convention. This will take effect on 1 January 2021, although an accompanying note on the Hague Conference website indicates that the United Kingdom considers that it continues to be a Contracting State, without interruption, from the date on which the Convention entered into force in the UK (that is, 1 October 2015).

e) Behaviour - EU Market Abuse Regime: The UK will transpose the current EU Market Abuse Regulation 596/2014 ("**MAR**") rules as at 31 December 2020, 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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