ALLEN & OVERY

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

Preparing for the end of the Brexit transition period – ten points relevant to mainstream debt capital market issuance

November 2020

Whilst Brexit formally happened when the UK left the European Union (**EU**) on 31 January 2020 (**exit day**), it has been treated as a Member State under Union law during the transition period established by the EU-UK Withdrawal Agreement. The transition period is scheduled to end on 31 December 2020, but it is still unclear whether the EU and the UK will reach a free trade agreement governing the future relationship. Even if there is success on this front, the UK is still expected to leave the single market on 31 December and any free trade agreement is unlikely to have a tangible effect on the mainstream debt capital markets. The points that parties considered ahead of a potential no-deal Brexit previously will again become relevant.

In light of this (and as an update to our previous publications), 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 the end of the transition period. As indicated in relevant places below, further developments are expected and we anticipate updating this publication to reflect those. Whilst 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 publication.

It is important to remember that the end of the transition period and departure from the single market will not result in a UK legislative and regulatory vacuum. The European Union (Withdrawal) Act 2018, as amended by the European Union (Withdrawal Agreement) Act 2020 (**WAA**), ensures a functioning statute book outside of the UK's membership of the EU by onshoring relevant provisions of EU law at the end of the transition (or, using WAA terms, implementation) period. Government departments have put in place a great many statutory instruments to fix "deficiencies" (for example, removing references to EU concepts, such as passporting) in the onshored EU law which come into force at, or prior to, the end of the transition period, unless provided otherwise.

1. London listed bonds should continue to be potentially eligible as collateral in Eurosystem operations, although issuers who view this as critical may consider an EU listing

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. When the transition period ends, the main market of the London Stock

© Allen & Overy LLP 2020

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 2019 the London Stock Exchange confirmed (as set out in a factsheet on its website) that 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 – would admit to trading London listed bonds on the ECB's eligible marketable assets list that satisfied MTS's admission criteria. This is an automatic procedure which should not result in additional obligations or costs for issuers. The London Stock Exchange has added London listed bonds, which were already on the ECB's list of eligible marketable assets as at 2 November 2020 and satisfied MTS's admission criteria, automatically to MTS, and will continue to make similar additions on a regular basis during the remainder of the transition period. From 31 December this year, bonds will be automatically admitted to trading on MTS at the point of London listing, provided they meet MTS admission criteria.

The potential divestment by the London Stock Exchange of Borsa Italiana Group, including MTS, in connection with achieving clearance for its purchase of Refinitiv may have an impact on this. The London Stock Exchange has been considering how to ensure that the divestment does not negatively affect the ECB eligibility of London listed bonds going forward and has published a statement to this effect. As such, we hope that the London Stock Exchange's approach will continue to provide a solution for ECB eligibility concerns around a London listing after the end of the transition period. However, issuers who regard potential ECB eligibility as a key feature of their debt securities may wish to consider an EU regulated or ECB-acceptable non-regulated market listing going forward.

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

At the end of the transition period, the ability to passport a prospectus between the UK and EU[1] under the EU prospectus regime will end. However, relevant UK exit regulations provide that prospectuses approved by an EU competent authority under the EU Prospectus Regulation and passported into the UK before exit day will be grandfathered for use in the UK until their validity expires. It is expected that this transitional provision will be updated by further exit regulations to facilitate the continued use of prospectuses passported into the UK before the end of the transition period. 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 the end of the transition period. Instead, we understand ESMA will update its Q&A on Prospectuses to confirm that prospectuses approved by the FCA and passported to the EU before the end of the transition period 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 EU following 31 December 2020.

Following the end of the transition period, therefore, issuers who would like their securities to be admitted to trading on a regulated market in the EU or to offer them to the public in the EU on a non-exempt basis will need prospectus approval from an EU 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 after the end of the transition period. They should consider whether their funding needs still require them to offer on a non-exempt basis across the EU; if so, they should factor in the need to seek approval of the base prospectus from an EU 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. The points highlighted here are unlikely to cause the same concerns in relation to London listed wholesale programmes, however, as FCA approved base prospectuses for such programmes are not in general passported to EU jurisdictions to achieve local listings.

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

 © Allen & Overy LLP 2020

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 will happen to the value of sterling once the transition period ends. 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 will be relevant for those issuers of sterling-denominated securities who wish to access EU markets following the end of the transition period and to have a choice over which EU 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 onshored prospectus regime, 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" in 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 the end of the transition period (from a domestic transparency and continuing obligations perspective), issuers with debt securities listed elsewhere in the EU will need to elect another home Member State in place of the UK to satisfy EU transparency requirements. ESMA has previously confirmed this in its Q&A on the Transparency Directive, 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; ESMA stated that such choice and disclosure should be made without delay following the UK's withdrawal and we expect this Q&A to be updated to refer to the end of the transition period.

5. Selling restrictions and legends will need to be revisited and other changes to documents must be considered

Since 31 January 2020, selling restrictions and legends (covering the public offer regime, PRIIPs and MiFID product governance) have in general followed the ICMA's transition period versions, which for clarity include references to the UK alongside references to the EU and EEA. When the transition period ends the UK will no longer be treated as a Member State of the EU and Union law will no longer be applicable in the UK. As a result, the ICMA will look to update its no-deal exit selling restrictions and legends (which include, for example, mirror UK selling restrictions), which were produced previously in case the UK left the EU without a withdrawal agreement in place. As before, we will be working on these updates in readiness for the end of the transition period. The ICMA will undertake similar work in relation to

standard language for stabilisation clauses and announcements and retail cascades wording, which we will also be involved in.

From the beginning of next year, market participants will therefore need to reflect these UK-related updates to selling restrictions and legends in standalone transactions and programme updates and will need to consider how to incorporate them in trades under programmes. Market participants will also need to consider the various other statements and references to EU legislation and concepts included in documentation. Depending on the scenario, these may be inappropriate (on, for example, UK only deals) or may need to be bolstered by the addition of references to the UK onshored position.

Similarly, once the transition period expires, programme issuers and parties will need to consider whether changes are needed at the time of or in advance of any trade. The ability to incorporate any such updates through trade documentation is helpful and avoids the need to try to future proof wording now, when there continue to be challenges around this. We hope, with regard to base prospectus disclosure, that competent authorities will regard relevant changes as minor and technical, such that an issuer need only update them at a convenient point in time next year, rather than through a supplement before issuance. However, we will watch for developments here.

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

After the end of the transition period, issuers who publish accounts using UK GAAP will still be able to use them to meet the UK’s onshored prospectus regulation regime. However, UK issuers using UK GAAP to list on EU regulated markets or offer to the public in the EU on a non-exempt basis will face more onerous disclosure requirements in their prospectuses. This is because, from 31 December, 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 EU regulated market after the transition period. 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.

In a similar way, after the end of the transition period, EU issuers that prepare their financial information according to national GAAPs will need to restate to UK-IFRS or include a narrative of differences from UK-IFRS (depending on whether the prospectus being prepared is “retail” or “wholesale”) when presenting financial information for years starting after Brexit in an FCA approved prospectus. (We assume the exit legislation reference to “exit day” here will be updated to refer to the end of the transition period.) The FCA’s Disclosure and Transparency Rules that will apply to listings on London’s regulated market (unless an issuer only has wholesale securities outstanding) do not envisage that it will be possible for an issuer to comply with filing requirements using EU national GAAP accounts, although there will be a transitional provision in relation to financial years beginning before the end of the transition period.

© Allen & Overy LLP 2020

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 after the end of the transition period. However, as the UK will be a non-EEA G10 country, debt securities issued by a UK issuer must be supported by a legal opinion in a form and substance acceptable to the ECB. The end of the transition period may also impact the ECB eligibility of securities in other ways. For example, where the ECB requisite credit standards are met through the presence of a guarantee, market participants should bear in mind that UK guarantors and English law-governed guarantees are not expected to meet ECB requirements.

8. Contractual recognition of bail-in required in English law-governed liabilities of EU banks and, subject to transitional provisions, EU-law governed liabilities of UK banks

Most EU 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 after the end of the transition period. From 31 December, it will also become necessary for EU 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 and agency agreements (or agency side letters for a programme) at the point of issuance, and via programme agreements and agency agreements at update of a programme.

In a similar way, contractual recognition of UK bail-in language will need to be included in the terms and conditions of UK bank issuer bonds governed by the law of an EU Member State after the transition period ends. "Other liabilities" of UK bank issuers, dealers/managers and agents governed by the law of an EU Member State will also require consideration, subject to transitional arrangements.

The requirements for the contractual recognition of EU and UK resolution stays in relevant contracts, such as subscription agreements, will also need to be considered by UK and EU banks, respectively.

9. Review listing covenants to ensure flexibility going forward

Whilst issuer listing covenants should be reviewed, it is unlikely that the transition period ending – 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 bonds.

© Allen & Overy LLP 2020

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 EU 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, many of the risks involved in including such clauses appear to arise irrespective of Brexit. Therefore, after the end of the transition period, 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 relevant client publications on our website.

Conclusion

The end of the transition period is fast approaching, and a delay is unlikely, although not impossible should it be necessary to facilitate the conclusion of any free trade agreement. Even if both sides are able to agree a deal governing the EU and the UK's future relationship, the points that parties previously considered ahead of a no-deal Brexit in relation to mainstream debt capital market issuance will continue to be relevant at the end of the transition period.

© Allen & Overy LLP 2020

Your Allen & Overy contacts

Amanda Thomas
Partner
International Capital Markets
+44 20 3088 2821
amanda.thomas@allenovery.com

Jennifer Cresswell
Counsel
International Capital Markets
+44 20 3088 4872
jennifer.cresswell@allenovery.com

Jonathan Melton
Partner
ICM – General Securities Group
+44 20 3088 2463
jonathan.melton@allenovery.com

Jamie Durham
Partner
ICM – General Securities Group
+44 20 3088 3842
jamie.durham@allenovery.com

Tom Grant
Partner
ICM – General Securities Group
+44 20 3088 3604
tom.grant@allenovery.com

Theo Trayhurn
Partner
ICM – General Securities Group
+44 20 3088 2913
theo.trayhurn@allenovery.com

Daniel Fletcher
Partner
ICM – General Securities Group
+44 20 3088 4651
daniel.fletcher@allenovery.com

Peter Crossan
Partner
ICM – General Securities Group
+44 20 3088 4464
peter.crossan@allenovery.com

Geoff Fuller
Consultant
ICM – General Securities Group
+44 20 3088 2806
geoff.fuller@allenovery.com

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts above or your usual Allen & Overy contact.

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute definitive advice. | UKO2: 2001359749.9