THE IMPACTS OF BREXIT ON DEBT CAPITAL MARKETS AND STRUCTURED FINANCE

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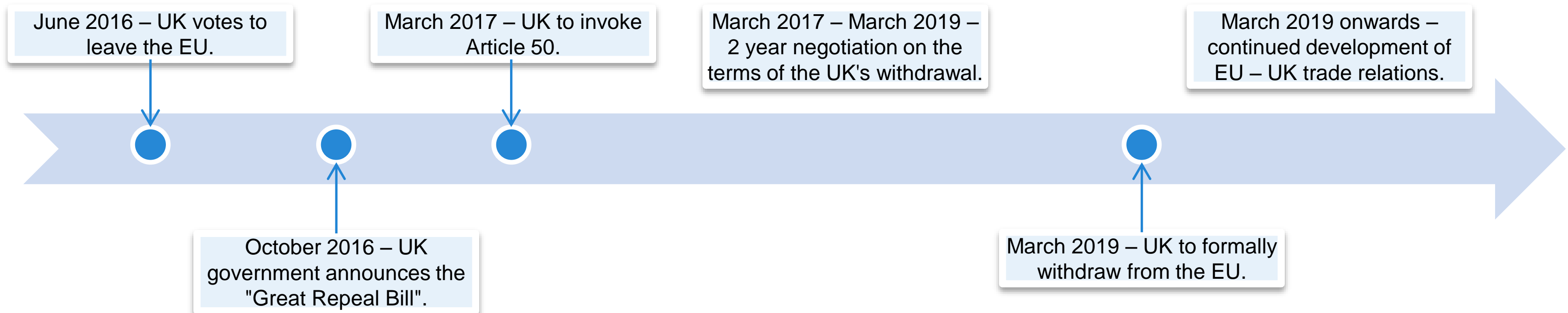
Introduction

- On 23rd June 2016 the United Kingdom voted to leave the European Union.
- The UK government will invoke Article 50 by the end of March 2017.
- "Hard" or "Soft" Brexit? A new relationship.
- Great Repeal Bill – all EU rules currently in force in the UK to be transposed to UK Domestic law.



- **Access to capital, liquidity and efficient markets in a stable environment benefit everyone.**

Debt Capital Markets

- Prospectus Directive & Regulation.
- On the basis of transposition into domestic UK Law, there will be no immediate effect on the requirements for, and the implications of, a UK listing (other than in respect of passporting).
- However, UK and EU listing rules and requirements may deviate slightly over time, for example in relation to:
  - the content & format requirements for prospectuses
  - the procedures for approving prospectuses in connection with listings,
  - requirements and procedures for publication of prospectuses
  - continuing reporting and disclosure obligations for listed companies.
- UK expected to continue to apply international standards to its Listing and disclosure regime to reassure investors so differences between UK and EU regimes not likely to be substantial.

Passporting under the Prospectus Directive

- It is likely that the UK will no longer be a participant in the Prospectus Directive's passporting regime for prospectuses.
- The UK's listing authority (currently the Financial Conduct Authority) would need to apply its own standards to prospectuses approved for listing in another member state.
- Conversely, prospectuses approved in the UK would need to be approved afresh by the regulatory authority in another member state.
- Potential reciprocity arrangements - the Prospectus Directive permits an EEA member state regulator to approve prospectuses approved in a "third country" (such as the UK) if it is drawn up in accordance with international standards and equivalent content requirements apply. The UK is likely to establish a reciprocal policy.

Market Abuse Regulation

- It is likely that the United Kingdom will be required to maintain a market abuse regime which is compatible with the requirements of the Market Abuse Regulation.
- Companies listed in the UK, will need to comply with the new obligations introduced under the Market Abuse Regulation:
  - Market soundings – new regime relating to the disclosure of inside information passed through wall crossings;
  - Persons discharging managerial responsibilities are required to notify transactions in securities within three days of a transaction taking place;
  - Listed companies are to publish their inside information without delay, save for in certain circumstances. Listed financial institutions may only delay disclosure of inside information with the prior consent of the FCA.

EMIR

- EMIR principles derive from G20 commitments given following the 2008 financial crisis. Material divergence between the UK and EU regulations is therefore unlikely.
- EMIR will still apply to EU-based counterparties of UK banks so any trade transacted with an EU entity would still need to comply with certain EMIR requirements (e.g. such as establishing and communicating to their counterparties their EMIR classification).
- UK trading entities would also need to maintain arrangements with central counterparties (CCPs), as their EU counterparties would require eligible trades to be cleared through an appropriate CCP.
- Third-country "equivalence" regimes are permitted under EMIR. Given the UK is already EMIR-compliant, it is likely (subject to political difficulties) that equivalency status will be granted.

Securitisations & Capital Requirements

- Under the Capital Requirements Regulation ("CRR"), the "*originator*, *sponsor or the original lender*" of a securitisation must retain at least a 5% net economic interest in the securitisation (percentage may increase under the STS Regulation).
- Under the CRR, in the majority of cases, a sponsor must be an EU regulated bank (i.e. credit institution) or an "investment firm" as defined in the CRR .
- "Investment firm" is defined in the CRR as certain investment firms authorised under MiFID. If the UK is no longer within the scope of MiFID, then this may impact certain structures e.g. UK collateral managers may not be able to act as "sponsors" for European CLOs.
- European CLOs (including those currently established) may require the collateral manager to "switch" to an "originator" structure .

Securitisations & Capital Requirements

- Proposed amendments to the STS Regulation may cause further restrictions:
  - entities acting as "*originator*, *sponsor or original lender"* may need to be *"regulated entities".*
  - only *"institutional investors"* (i.e. specific types of EU regulated entities) will be able to invest in securitisations .
- However, proposed amendments are still being developed and the STS Regulation is not intended to be retrospective in its effect.
- Interim solution - Structure risk retention so that the UK collateral manager acts as an originator retention holder, either upfront or as a back-up option. UK collateral managers would originate a small proportion of assets for each CLO in order to qualify as an originator retention holder.

Securitisations & Capital Requirements

- The progress of both the Brexit negotiations and the proposed amendments to the STS Regulation will be key – particularly "".
- If it becomes clear that there will be a period during which UK collateral managers cannot act as sponsor retention holders (either due to Brexit or due to the STS Regulation), transaction parties can consider amending existing transactions to incorporate an originator option.
- In many cases European CLO documentation already permits the amendment of transaction documents in order to comply with EU risk retention, though the detailed contractual provisions of each transaction will need to be considered.

Asset Management – Sales and Marketing

- **UK AIFM & EU AIF**
  - Marketing an EU AIF in the EU would require extension of the AIFMD passport to the UK as a third country operating regulations “equivalent” to the AIFMD.
  - The UK AIFM could reapply for EU authorisation through an EU “member state of reference” such as an EU Gateway Hub (Ireland, Luxembourg) or alternatively rely on private placement under the national private placement regimes (NPPRs) of individual member states where available.
  - A self-managed AIF could also be established in an EU Gateway Hub, with the portfolio management function delegated to the UK manager.

Asset Management – Sales and Marketing

- **UK AIFM & non-EU AIFs**
- Currently, a non-EU AIFM can only market a non-EU AIF to EU professional investors on a private placement basis. This requires that the conditions set out in Article 42 of the AIFMD are satisfied:
  - Transparency requirements .
  - Appropriate co-operation arrangements for systemic risk oversight.
  - The third country where the non-EU AIF is established must not be listed as a non-co-operative country and territory by the Financial Action Task Force (FATF) for anti-money laundering (AML) and counter-terrorism financing (CTF) purposes.
- Individual member states will have different national private placement regimes (NPPRs), so UK AIFMs seeking to market non-EU AIFs will have to deal with each EU member state on a case by case basis.
- Article 35 and Articles 37 to 41 of the AIFMD contain provisions that will have the effect of extending the AIFMD passport regime to the management and marketing of AIFs by non-EU AIFMs and to the marketing of non-EU AIFs by EU AIFMs where regulatory regimes are equivalent.

Asset Management – Sales and Marketing

- **Other third country AIFMs**
- The UK Government could permit other third country AIFMs to market their AIFs in the UK under the UK's pre-AIFMD private placement regime, or article 42 in the same way as they do at present. The marketing of AIFs by third country AIFMs into the rest of the EU should not be affected by a Brexit.
- **UCITS - management and marketing by UK Managers**
  - While existing UK UCITS would cease to qualify for the UCITS marketing passport, the majority of funds are set up in EU Gateway Hubs so would be largely unaffected.
- **UCITS - management and marketing by Non-UK managers**
  - UK rules similarly permit EU and non EU managers to act as delegates for a UK retail fund provided certain standards are achieved.
  - Without the UK's existing UCITS inward passporting regime, an EU UCITS would no longer have automatic access to the UK retail markets. However, obtaining approval as a UK recognised scheme which would give it equivalent marketing rights, is likely to be easy.

MIFID & MIFID II

- There is no common third country regime under MiFID. Any third country bank intending to provide services in a particular EU jurisdiction must either:
  - be established as an authorised entity in that Member State and authorised under MiFID; or
  - establish an authorised subsidiary in a Member State and rely on passporting rights across the EU.
- MiFID II likely to replace MIFID in 2018:
  - Separate regimes for third country institutions doing business with retail clients and professional clients based in the EU.
  - In most cases, UK banks will only be able to conduct regulated investment business with retail clients if they have establish a branch in that Member State. This should not be problematic for UK based institutions.

MIFID & MIFID II

- UK banks will be able to do business with professional clients in Member States under MiFID II without establishing a branch in that Member State as long as it's regulatory scheme is considered equivalent by ESMA.
- In particular, it would be possible for Member States and the Commission to take the political view not to provide equivalence to the UK in financial services.
- While the UK may chose to dilute or remove some elements of MiFID II (e.g. position limits, equity transparency, liquidity thresholds), it is likely that the UK government will prioritise obtaining equivalency status.

Conclusion

- Recent comments from the UK government indicate that an equivalency based approach will be pursued rather than one based solely on passporting.
- On the basis that the government intends to implement existing EU legislation in UK domestic law, it is reasonable to assume that the UK's regulatory environment will be equivalent at the point of exit from the EU.
- Both UK and EU citizens benefit from deep capital markets which operate effectively. Political solutions should therefore be pragmatic.
- However, it is understandable that businesses will look to mitigate any potential risk arising from changes to legislation over the next two years.