HERBERT SMITH FREEHILLS

Capital markets

SEPTEMBER 2019

If the terms of a transition period are agreed as part of the Withdrawal Agreement, existing market arrangements are expected to be maintained for some transitional period. However, until clear agreement is reached on both the term's of the UK's exit and any future free trade agreement, the possibility of a 'cliff-edge' scenario in 31 October 2019 or December 2020 or later remains and given the short time periods involved businesses need to be prepared for the possibility of a hard Brexit.

Pursuant to the terms of the Withdrawal Act directly applicable and operative EU laws will be converted into UK law at the point of the UK's exit from the EU. The Market Abuse Regulation and Prospectus Regulation would be incorporated into UK law through this mechanism, as would national legislation implementing EU Directives. Regardless of which EU laws are converted into UK law and when, over time relevant legislation will be amended to give effect to the UK's post-Brexit listing and prospectus regime. The shape of these amendments is likely to depend on the terms of any free trade agreement between the UK and the EU27. We believe that UK regulators are likely to continue to require adherence to standards equivalent to the requirements imposed by the Prospectus Regulation, Transparency Directive and Market Abuse Regulation, in order to maintain the strength of the London Stock Exchange's global brand. Substantial divergence away from these standards seems unlikely given: (i) the extent of the UK's historic and current involvement in the development of the Single Market for EU financial services and in developing standards supported by international listing venues;
(ii) that there is unlikely to be significant political pressure to make changes in this area; and
(iii) that Switzerland, as an EFTA but non- EEA member, has recently overhauled its regulatory framework for capital markets to bring it closer into line with international standards, and in particular the Prospectus Regulation.

On the other hand, it is possible that the UK authorities could decide to change aspects of the regulatory regime, relaxing some provisions or making some more stringent, on the basis that choice of listing venue is determined by a number of factors, including access to potential investors, the valuation of similar companies listed on the exchange and liquidity. Choice of listing venue is not therefore driven solely by the level of continuing regulation and disclosure required and to a degree at least, removal of

The section is part of our Brexit Legal Guide.

Brexit sources of information relating to capital markets:

No Deal

- If the Withdrawal Agreement endorsed by the EU Council on 25 November 2018 or the Political Declaration, or some version of both, are not approved by 31 October 2019 and there is no change to the exit date, the UK will cease to be a member state on that date without any transitional period
- The body of EU law in force at that time will be imported into UK law (with necessary amendments) under the European Union (Withdrawal) Act 2018 and UK legislation made to implement EU law will be retained, with suitable amendments – this is called 'retained EU law'
- A lot of the secondary legislation to adjust retained EU law for the post- Brexit world has already been made for example, making minor amendments to the retained

certain administrative burdens could make the UK more attractive as a listing venue.

The current passporting provisions for prospectuses prepared in the UK for use elsewhere in the EU and vice versa will not continue post-Brexit unless any free trade agreement between the UK and the EU27 includes arrangements for mutual recognition of prospectuses. It remains to be seen whether this will be a feature of the post-Brexit landscape. Currently, an EU member state has the option to approve a prospectus drawn up by a non-EU issuer if it has been drawn up in accordance with international standards that are equivalent to the requirements under the Prospectus Regulation. The European Commission has the power to decide whether a third country's law or practice is sufficient to satisfy the EU equivalence test for this purpose. It could therefore make this determination in respect of prospectuses prepared under UK law and approved by the FCA. Similarly, HM Treasury and the FCA could decide to continue to accept prospectuses approved in an EU member state for the purposes of making a securities offering in the UK. In this respect the mutual recognition relationship between the EU27 and the UK will be unlike any other third country regime because it will start from the historic position of the same regulatory and supervisory system. However, it is also worth remembering that passporting is rarely relevant in the context of IPOs, given that few IPOs are marketed to retail investors in more than one member state. Passporting is more relevant to rights issues where there are lower numbers of retail investors in more than one member state. For these, individual approvals would be required in each such member state absent a prospectus passporting mechanism. In the context of debt capital markets, the potential loss of passporting should not have a large impact as issuers will be able to continue to make offers in the EU where an exemption under the Prospectus Regulation is available – for example, offers of wholesale debt securities or offers solely to institutional investors.

If it is not possible to rely on full regulatory equivalence, another option will be for firms involved in international capital markets to be authorised, capitalised and staffed in both the UK and the EU27 where that is not the case already. This has significant cost implications and may provoke financial instability – careful coordination between UK and EU27 supervisors will be critical.

The effect of Brexit on the future plans for the creation of a new EU capital markets union (CMU), which aims to promote the concept of a single market for capital, currently remain unclear. The CMU is a European Commission initiative to strengthen capital markets in Europe. It comprises a range of reforms targeted at specific sectors and the overall EU supervisory structure. Its primary objectives are: (i) to help businesses (including small and medium-sized enterprises (SMEs) reduce their reliance on bank-funding and access alternative sources of capital; (ii) to make markets more efficient generally; and (iii) to offer investors a wider choice of financial instruments to meet their needs. The new Prospectus Regulation, referred to above, is part of the CMU.

The UK has been a strong supporter of the CMU since its creation. It remains to be seen how successfully the EU27 are able to channel their expertise to further develop and strengthen the initiative without the involvement of the UK and, further, so that they can compete for capital markets transactions against the UK as a third country.

> "The capital markets regulatory regime post a no-deal Brexit remains unclear pending negotiation, particularly around equivalence and passporting."
>
> **CHARLES HOWARTH**

Market Abuse Regulation, or is in draft, for example, in relation to the Prospectus Regulation

- The UK Financial Conduct Authority has also consulted on changes to its rules that will be necessary as a result of a no-deal Brexit in relation to the governance of listed companies

Deal/transitional period

- If approved by the UK Parliament, the Withdrawal Agreement, or some version of it, will set out arrangements for the UK's withdrawal from the EU - when the UK will cease to be a member state
- A transition period will follow the date of the UK's EU exit up till at least the end of 2020, possibly the end of 2021 or 2022
- During transition, EU law will continue to apply in and to the UK and the UK will continue to trade as part of the Single Market
- The Withdrawal Agreement will be accompanied by the Political Declaration on the future relationship between the UK and the EU. This will comment on the future trading relationship between the EU and the UK

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