Finance and insolvency

SEPTEMBER 2019

Contractual considerations

The two most often-posed questions relating to the effect of a no-deal Brexit on financing contracts relate to (i) the choice of English law as the governing law of the transaction, and (ii) the ease with which an English judgment could be enforced in an EU27 jurisdiction, against, for example, an obligor or assets in that jurisdiction.

- Choice of English law: the UK's exit from the EU should not have any effect on the willingness of contracting parties to choose English law as the governing law of a contract. More detail is provided in the Contracts section of our Brexit Legal Guide; broadly, the courts of EU27 member states would be obliged to respect the choice of English law (or any other governing law) as the governing law of a commercial contract under the existing EU Rome I Regulation. The UK will adopt similar rules as part of EU on-shoring after Brexit.
- Jurisdiction and enforcement of English judgments: The loss of reciprocity in relation to submission to jurisdiction and the enforcement of English judgments in the EU27 may require further consideration when structuring and documenting a transaction, depending on the EU27 jurisdictions involved. Again, more detail is provided in the Disputes section of our Legal Guide.
  - While the UK will accede to the Hague Convention on Choice of Courts Agreements 2005 in its own right on the day after it leaves the EU (probably 1 November 2019 if there is no deal) or at the end of any transition period, this will only assist in the enforcement of English judgments in the EU27 (as well as Singapore, Mexico and Montenegro) where an exclusive English jurisdiction clause is used. These are relatively common in derivatives transactions, but are not (yet) used often in syndicated loans based on the Loan Market Association recommended forms of documents. There is also some potential uncertainty over whether EU27 countries would apply the Convention where an exclusive English jurisdiction clause was agreed before the date on which the UK accedes to the Convention in its own right (even though the UK has for some years been a party to the Convention by virtue of its EU membership). On the face of it, it is not easy to see why the Convention should not be treated as having been in force from the earlier date. However, guidance issued by the European Commission in April 2019 suggests it is taking the view that exclusive English jurisdiction agreements are within the Hague Convention only if they are entered into post-Brexit, although this is not of course binding on domestic or EU courts that will decide this question in future.
  - If no agreement or convention applies to a particular agreement then each country will apply its own domestic rules to questions of jurisdiction and enforcement. When it comes to the English courts, that means in most cases the common law rules, and the upshot is that the court will generally respect an exclusive jurisdiction clause in

The section is part of our Brexit Legal Guide.

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, see the accompanying section: The UK's new legal order post-Brexit
- The Government has published a series of 100+ practical no deal notes with advice, including on banking and financial services and dispute resolution

favour of another country and will generally enforce money judgments given by other countries, subject to limited exceptions.

- So far as enforcement of English judgments is concerned, most (but not necessarily all) EU countries will enforce foreign judgments even without a specific reciprocal regime, although the type of judgment enforced may be more limited and the procedures involved more time-consuming and costly. There may also be some question marks about whether EU member state courts would give effect to an English jurisdiction clause in these circumstances, particularly where proceedings were started in the EU member state before they were started in England and that member state has an alternative basis for taking jurisdiction.
- Arbitration with a seat in London will not be affected by the exit from the EU. Arbitration is not regulated by EU law, and the UK is a signatory to the New York Convention 1958, which has a well-drafted and clear piece of modern arbitration legislation, an impartial and well-regarded judiciary and a strong track record in supporting arbitration and enforcing arbitral awards. All EU member states are also signatories to the New York Convention, meaning that enforcement of UK-seated arbitral awards in those states, and EU member state-seated arbitral awards in the UK, will be unaffected.

Changes to the regulatory landscape

Much of the impact on financing arrangements of the UK leaving the EU will arise as a result of the changes to the regulatory landscape that will occur upon such exit, whether that is at the end of the transition period or, in the case of a no-deal Brexit, probably on 31 October 2019. Many of the effects can be mitigated by changes in how the provision of services is structured within a bank, which may already be permitted by legacy contracts. The wider effects of the UK leaving the EU on banking and investment firms are discussed in the Banking and investment firms section in more detail; in this note we will focus on financing arrangements specifically.

If the Withdrawal Agreement is signed and the Political Declaration agreed and there is a transition period then, until the end of that transition period, EU law will continue to apply in the UK and the passporting regime will continue, and in the short term at least, the effects of the UK leaving the EU will be postponed again.

If there is no deal, or transition ends without alternative recognition arrangements being in place, the regulatory position of UK entities providing financial services into the EU27 will change quite significantly. This change could come as soon as 31 October 2019. However, there are a number of mitigants in this scenario that can be incorporated into financing arrangements.

In general, the future regulatory approach of the UK will be to treat EEA member states and EEA firms consistently with other third countries and firms. However, some temporary divergence from this principle is contemplated, particularly in a no-deal scenario, in order to minimise disruption and avoid material unintended consequences for the continuity of financial services provision, to protect the existing rights of UK consumers, or to ensure financial stability. The most prominent practical example of this is the Temporary Permissions Regime (TPR). The TPR will, if the UK leaves the EU without an implementation period, allow EEA banks and investment firms currently passporting into the UK to continue operating in the UK for up to three years after exit, pending full authorisation from UK regulators. Similar arrangements will apply to financial market infrastructure providers, electronic money and payment institutions, registered account information service providers, and EEA securities and funds that are offered or marketed into the UK.

One area where mutual recognition will not be achieved is for transaction reporting data repositories (which must relocate and/or re-establish new entities in both the UK and EU).

Lending: regulatory change

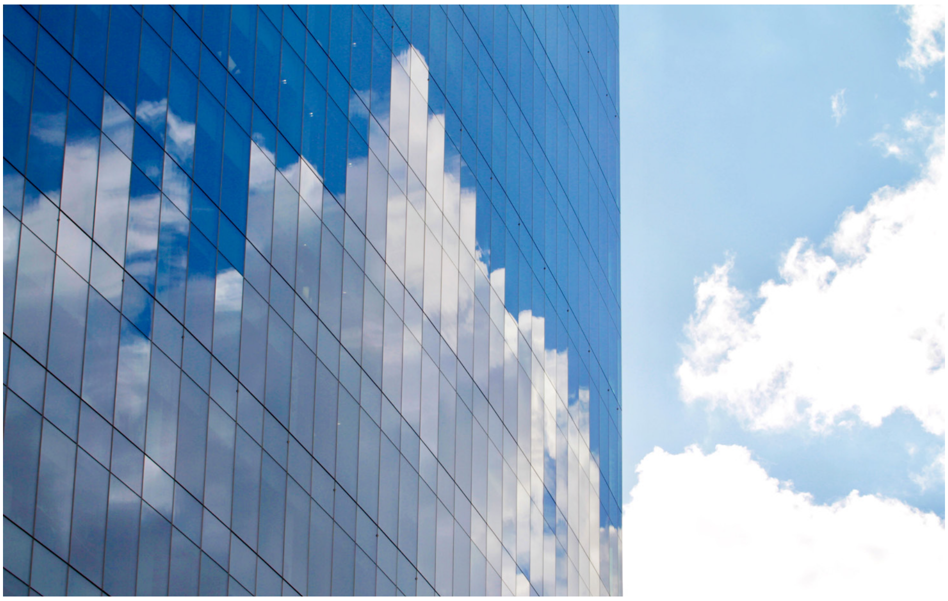
The regulation of lending is dealt with under the Capital Requirements Directive, which leaves the regulation of cross-border services provided by non-EU banks to the national law of each member state. There are a number of services which a lender may provide as part of its lending activities, such as letter of credit or bank guarantee issuance; performance of facility agency, security agency and other agency roles; and provision of bank accounts. Further, lending itself can be broken down into the provision of several services, both in the initial marketing phase and in actually making funds available.

These services are not all regulated in all individual EU countries: for example, lending to most businesses is not regulated in the UK. The analysis in relation to exactly what activity is regulated in which jurisdiction is complex, jurisdiction-specific and fact-specific and relies on a myriad of exemptions and carve-outs. Because these issues are regulatory rather than strictly legal, judgment calls and differences in regulatory approach can add to the uncertainty and complexity.

- The UK Financial Conduct Authority and Prudential Regulation Authority have also consulted on changes to their rules that will be necessary as a result of a no-deal Brexit
- The FCA has published information on the temporary permissions regime for inbound passporting and on participation in the wholesale markets
- The Bank of England has also published information on the temporary permissions regime and on financial market infrastructure supervision

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. In article 30 of the current text, there is a commitment to a wide-ranging agreement removing discrimination in service sectors "with appropriate exceptions and limitations", with financial services being specifically mentioned
- This means that much of the impact of Brexit on financing arrangements will be delayed until the end of the transition period (by which time the hope is that the various potential issues will have been resolved in the context of a new trading relationship, at least to some extent):



Analysis of the regulatory position of each relevant entity is the first step to be undertaken. Once that is established, the lending arrangements can be structured to mitigate the risk of the loss of passport. This may be by building in additional flexibility to adapt the lending platform to lend out of a different facility office or group entity, tranching facilities being lent to different borrowers in the same group of companies, and increasing the level of oversight and control over the accession of future borrowing entities. The same concerns may also arise in the context of the shorter form commitment documents such as mandate letters, particularly where they span the end of October. Borrowers and lenders will wish to consider the impact of regulatory disruption on illegality and force majeure clauses in market documentation.

Securitisation

In addition to the issues discussed in the Finance and Capital Markets sections, the securitisation market in the UK and EU will experience a number of specific adjustments in a no-deal scenario.

The new EU Securitisation Regulation ('EU SR'), which aims to harmonise and enhance the regulatory framework applicable to securitisation in Europe, was approved by the European Parliament on 26 October 2017, entered into force on 1 January 2018 and became directly applicable across the EU from 1 January 2019 to securitisations established following that date (subject to certain transitional arrangements). In a no-deal scenario, the SR will be incorporated into English law ('UK SR') with the amendments provided in the Securitisation (Amendment) (EU Exit) Regulations 2019.

The EU SR will not prevent non-EU securitisations from being sold in Europe (or vice-versa), but regulated investors in the EU and the UK will not be able to take positions in securitisation transactions which do not comply with the requirements in the EU SR (in the case of the EU-regulated investors) and UK SR (in the case of the UK-regulated investors). The SR also imposes obligations directly on originators and securitisation SPVs, so if the EU SR and UK SR diverge over time, UK securitisations which are sold to EU regulated investors (and EU securitisations which are sold to UK regulated investors) will become subject to a dual compliance burden. This risk is particularly relevant to this area of legislation as it is still under development, with a number of items of subordinated legislation still outstanding and expected to remain so until, at the earliest, Q4 of 2019. In respect of those technical standards which are required to be implemented under the EU SR but have not become law by exit day, the UK legislature will need to adopt equivalent measures to those which are ultimately adopted in the EU if the UK regime is to remain consistent.

Even in the absence of regulatory divergence over time, the EU SR and UK SR will differ in certain respects. One material difference concerns the new category of "simple, transparent and standardised" ('**STS**') securitisation created by the EU SR. STS securitisations are eligible for more favourable treatment for capital and liquidity purposes in the hands of regulated banks, investment firms and insurance undertakings. The EU SR has adopted a jurisdictional requirement in relation to STS status: transactions where any of the originator, sponsor or SPV are established outside the EU will not be able to achieve STS status. The UK SR has adopted a similar but slightly more flexible version of this position: for

- Any directly applicable EU legislation, such as the European Market Infrastructure Regulation (EMIR, No 648/2012), the recast Insolvency Regulation (No 2015/848), and the Securitisation Regulation (No 2017/2402) will continue to apply in the UK until the end of transition and may form part of retained EU law thereafter (see accompanying section: The UK's new legal order post-Brexit); and
  - issues relating to reciprocal arrangements regarding enforcement of judgments and cross-border insolvency arrangements between UK and EU jurisdictions will continue to apply, again until the end of transition; and
  - passporting arrangements will also continue until after transition
- Whether or not the Withdrawal Agreement or the Political Declaration, or some version of both, are approved by 31 October 2019, the UK will cease to be an EU member state on that date, unless the date for the UK to leave the EU is extended again by agreement between the UK and the EU27 or the Article 50 notice is withdrawn. If there is an approved deal and the UK enters transition, as explained above, the legal position during transition will be very similar for businesses as if the UK were still an EU member state

standalone transactions, the issuer need not be established in the UK (but the sponsor and originator must be), and for ABCP transactions only the sponsor must be established in the UK. These concessions are welcome, but nevertheless the general result is that in a no-deal scenario securitisation transactions with an originator, sponsor or issuer in the UK will not be able to achieve the "STS" label for the purposes of EU investors, and EU securitisation transactions will not be able to achieve the STS label for the purpose of UK investors. The STS framework is in its early stages of application, but the creation of two different regimes is likely to frustrate one of the purposes of the legislation, which is to promote a liquid market in STS securitisation bonds.

There are a number of other points of detail which will need to be worked through for transactions which have both an EU and a UK investor base. For example, a securitisation which is obliged to be compliant with the disclosure requirements under both the EU SR and the UK SR may need to upload the specified disclosure materials to a securitisation repository authorised and established in the EU, and also to a securitisation repository authorised and established in the UK. It would be prudent to identify when planning a new transaction (or where amendments may cause a transaction to cease to be grandfathered) whether only one or both of the regulatory regimes will be relevant. It is to be expected that further issues will be identified or arise as the legislation and market practice develops.

Similarly, asset backed securities involving a non-EEA originator, a non-EEA issuer or any non-EEA assets are not eligible for placement as collateral with the European Central Bank. There are certain other geographical limitations which may also be relevant, including for example the law of the contract of sale of the collateral assets. At this stage the Bank of England has maintained a more flexible approach, so EEA securitisations can be used as collateral for the Bank of England liquidity purposes (subject to satisfaction of the existing criteria and restrictions). However, each central bank has the ability to review and adjust its criteria over time.

Derivatives

The consequences of economic volatility, in terms of fluctuations in exposures and asset valuations, and possible effect on counterparty creditworthiness, also impact the derivatives market.

The issues we considered above in relation to financing documentation will also arise under derivative trading documentation. One question which particularly arises in this area is whether a UK exit will make the performance of derivative contracts entered into from a UK entity or branch with an EU27 entity prior to a UK exit, and in particular certain activities forming part of the contract or related to it which might require further authorisation after a UK exit, illegal or unlawful if performed by an unlicensed UK firm or branch. This is the 'continuity' issue, which potentially impacts other products as well, such as loans and insurance. Much lobbying of EU institutions, regulators and legislators has been taking place in relation to this issue and has borne some fruit, at least in the UK, France and Germany, where the legislators are aiming to address a number of the concerns voiced in the market. However, this has not been a complete solution, and affected financial services firms have been transferring business units, portfolios and clients to EU jurisdictions to ensure business continuity post-Brexit. Following the extension from March to October, much of this re-organisational work is complete. The other prime area of concern for this market is the impact of a Brexit on derivatives regulation, in particular the European Market Infrastructure Regulation ('**EMIR**'). Certain market infrastructure problems identified as cliff edge issues on an exit without a transition period are addressed by the EU legislators; in particular, regulatory technical standards have been published providing limited exemptions from the EMIR margining and clearing obligations upon a novation, which is key for financial institutions and their counterparties where portfolios of trades are being transferred to other group entities to address a loss of passporting rights.

The UK has also published statutory instruments to on-shore EMIR (and other relevant derivatives legislation, such as SFTR) and has also published draft legislation which would allow the Government, in case of a no-deal Brexit, to implement aspects of key pieces of EU "in-flight" financial services legislation which are not operative on exit day and so are not transferred onto the UK statute book. This would include updates to the BRRD, which is discussed in more detail below. A draft statutory instrument has also been published to on-shore the recent update to EMIR (EMIR Refit). However, it should be noted that various aspects of EMIR Refit which have delayed implementation, such as changes to dual sided reporting obligations, which are not in effect when Brexit occurs will not be on-shored through the Withdrawal Act and so further legislation will be needed. This lack of certainty is causing some concerns in the market.

Equally, there has been discussion on financial stability issues, such as continued access for

UK and EU CCPs for EU and UK clearing members respectively; this has been addressed to date in the UK through a statutory instrument providing for temporary recognition of EU CCPs and in the EU through a temporary regime. One issue which continues to trouble the market in this area is the treatment of UK and EU trading exchanges, and the lack of mutual EU/UK recognition thereof, as this raises issues with compliance with trading/clearing obligations as well as treatment of exchange-traded portfolios.

Transaction finality and the realisation of security

There are elements of EU financial services laws which impinge on insolvencies and remove uncertainties, such as settlement finality and financial collateral legislation.

If there is no transition period, on 31 October 2019 UK payment and securities settlement systems will lose the protections from the impact of insolvency proceedings on the finality of settlement and on the enforcement of collateral afforded to such systems in EU27 member states under the Settlement Finality Directive; again, these protections rely on reciprocity between the UK and the EU27 which will be lost once the UK ceases to be an EU member state if there is no transition period. However, the UK legislation to be adopted if there is a no-deal Brexit contemplates that central banks outside the UK and systems which are not governed by UK law will be able to fall under the UK regulations and retain these protections in the UK, subject to being appropriately designated by the Bank of England. Further, EEA systems that fall under the EU Settlement Finality Directive on exit day will continue to benefit from temporary transitional relief in the UK for three years.

The Financial Collateral Regulations (which stem from the EU Financial Collateral Directive) are now well entrenched in domestic law in the UK and will continue, largely unamended, even if there is no Withdrawal Agreement and no deal. Equally, the application of the Financial Collateral Directive to collateral in the remaining EU member states should continue after the UK leaves the EU, even if that collateral has been posted by a UK institution. However, there remains some uncertainty in relation to the interaction of the Recast Insolvency Regulation (which is discussed in more detail below) with the financial collateral regime implemented in the EU 27; it is possible that the protection afforded to UK collateral in EU insolvency proceedings after 31 October 2019 if there is no deal could be narrower than it would have been had the UK remained subject to the recast Insolvency Regulation.

There are also circumstances where acts subject to the law of an EU member state, and not capable of being challenged under the law of that member state, may currently be excluded from challenge in the insolvency of a counterparty in another member state. These protections as applicable to English law governed financial arrangements (and to restructurings of secured English law facilities with EU27-incorporated obligors) fall away once the UK is no longer part of the EU, if there is no transition period.

In terms of more standard credit support arrangements, there should be no effect on English law security over assets located in the UK or English law guarantees. However, the position may be more complicated where assets or rights to be secured arise as a result of, or are very closely entwined with, EU or EU member state law. For example, certain intellectual property rights arise under EU law (for further details see the Intellectual Property section), and security over those rights is perfected by registration at an EU level.

Restructurings and insolvency processes

Issues will arise upon a UK exit in relation to restructuring tools such as schemes of arrangement and in relation to insolvency processes, whether that is at the end of the transition period or, in the case of a no-deal Brexit, on 31 October 2019. There are also special EU insolvency rules for financial institutions, which will be affected.

Schemes of arrangement have been used in the UK in recent years to restructure the financial indebtedness of a significant number of overseas companies, including those incorporated in other member states. In order for the English court to accept jurisdiction to sanction a scheme of arrangement proposed by a foreign company, it must be satisfied that there is a sufficient connection with England, and that the scheme will be recognised in the relevant foreign jurisdiction. It has not yet been necessary for the English courts to determine whether the EU Recast Judgments Regulation has the effect of limiting its jurisdiction to sanction a scheme proposed by a foreign company. Once the Recast Judgments Regulation no longer applies to the UK (on 31 October 2019, if there is no transition period), the debate as to whether it curtails the jurisdiction of the English courts falls away. However, the English courts will still need to be satisfied that any order made will have effect in the relevant jurisdiction (enforcement of judgments is discussed in more detail in the Disputes section). If the EU Recast Judgments Regulation is no longer an available avenue, which would be the case on 31 October 2019 if there were no transition period, recognition would have to be established based on national rules of private international law. Ultimately, non-UK companies with English law liabilities seeking to establish scheme jurisdiction in the UK based on a centre of main interests shift may become more open to challenge in their EU state of incorporation, increasing the risk of a competing process in the EU.

In relation to insolvency proceedings, the EU Recast Insolvency Regulation aims to establish procedural rules on jurisdiction and applicable law and to aid the mutual recognition of cross-border insolvency proceedings commenced in a member state where the debtor has its centre of main interests; it does not further seek to harmonise substantive insolvency law. It has direct effect in all member states other than Denmark. If there is a transition period, the draft Withdrawal Agreement envisages that the Recast Insolvency Regulation will continue to apply to insolvency proceedings where the main proceedings were opened before the end of the transition period. If there is no transition period, on 31 October 2019 there will no longer be automatic recognition of UK insolvency proceedings in the EU27 member states pursuant to the Recast Insolvency Regulation, although the UK has adopted legislation which means that existing and new EU27 insolvency proceedings will be recognised in the UK courts: reciprocity would be lost.

The UK has already adopted the UNCITRAL Model Law on Cross-Border Insolvency, which has been adopted in jurisdictions such as Australia, the US and some EU member states (Greece, Poland, Romania and Slovenia), but elsewhere in the EU27 the UK insolvency office holder would be left to rely on older cross-border insolvency rules in the jurisdiction where recognition is sought. It may be that, following a UK exit, other EU27 member states will adopt this law. Absent that, or other steps being taken in the EU, there is, at worst, a risk of competing insolvency proceedings taking place; at best, some scope for delays and uncertainty. Through its adoption of the Model Law, the UK does provide for recognition of foreign insolvency proceedings (regardless of whether the foreign company is in a jurisdiction which has itself adopted the Model Law), albeit on a more limited basis than under the Recast Insolvency Regulation. The Model Law is not, however, applicable in the event of the insolvency of a bank or insurance company and proposed amendments to the 2004 Regulations mean that EEA Banks will be treated in the same way as third country banks, with consequent different treatment of contracts in the event of a UK insolvency from that applicable to the equivalent contracts of an insolvent UK bank. It is to be hoped this discrepancy will be addressed by further legislation.

The regime for cross-border resolution of banks (the EU Bank Recovery and Resolution Directive ('**BRRD**') is another key piece of insolvency legislation that will be affected by Brexit. If there is a transition period, it will continue to apply. However, if there is no transition period, on 31 October 2019 the UK legislation which has been published indicates that there will be a reduction in the cooperation between the UK and the EU27, in that EU27 financial institutions will be treated in the same way as other third country financial institutions and the specific regime for recognising EU resolutions will be repealed. While there is a process for the recognition of third country resolutions which will apply to EU resolutions, its application is at the discretion of the Treasury and the Bank of England, and the inter-relation with UK insolvency law is more uncertain than where EU law applies. It is hoped and expected that the Bank of England will enter into bilateral and multilateral cooperation arrangements with other authorities in the EU27 and this sort of arrangement between the EU or individual EU member states is contemplated in the BRRD. When it comes to insolvency, however, special EU financial market protections will largely cease to apply in the UK. This increases the risk of UK insolvencies of EU financial institutions, where the UK would previously have recognised the insolvency process commenced in the institutions home member state. This situation currently applies to third country financial institutions operating in the UK, but the size of the EU presence in the London market, increases the inconveniences of this situation. Nevertheless, in some cases general law should reach the same result. Further, certain aspects of EU resolution such as bail-in may no longer automatically be respected in the UK insolvency of an EU financial institution or vice-versa. The failure of an EU-incorporated financial institution would therefore have a greater effect on the UK markets if there is no deal and no transition period unless these points are addressed, as they should be, given the commitments of the EU and the UK to the G20 and Financial Standards Board recommendations on cross border insolvency of financial institutions. In the EU the position in relation to the insolvency of UK banks in those circumstances is equally until clear, and it is likely to vary according to the national insolvency law of the relevant EU27 member state.

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"Other than the bank's choice of facility office, the UK's exit should not have a significant effect on English law governed syndicated lending arrangements."

WILL NEVIN