BREXIT AND FINANCE TRANSACTIONS **FEBRUARY 2020**

In this article, we set out an overview of the status of Brexit in relation to issues in finance transactions. We look at the position where there is a deal between the EU-27 and the UK and where there is no trade deal. The European Union (Withdrawal) Act 2018 ("**2018 Act**") repeals the European Communities Act 1972 (the "**ECA**") on 31 January 2020, ("**exit day**"). However, the European Union (Withdrawal Agreement) ("**2020 Act**") amends this providing (largely) for the ECA to continue to have effect until the end of the implementation period (defined as "**IP completion day**"), the end of the transition period, which UK legislation is calling the implementation period. The 2020 Act also revises the date on which the bulk of the statutory instruments dealing with Brexit will come into force from exit day to IP completion day. For the most part, there will, therefore, be little or no change to the current position during the implementation period.[1]

Here are the main areas discussed in this briefing in relation to finance transactions.

- Regulatory and passporting - What contractual provisions should we consider?
- LIBOR - What happens to LIBOR as a benchmark rate?
- Increased Costs – Will this clause still operate?
- Sanctions – Should we still use the same sanctions following Brexit?
- Contractual recognition of bail-in clauses – How will things change after Brexit?
- Governing law – Do we need to change the governing law in our finance documents?
- Jurisdiction - Do we need to amend the jurisdiction clause in our finance documents?

Regulatory and passporting - What contractual provisions should we consider?

Where the UK has a Deal, the implementation period will end on 31 December 2020. However, in terms of the revised Political Declaration, the UK and EU-27 will have to start work on cooperating on the equivalence framework for regulatory and supervisory regimes as soon as possible. This is far from a complete picture and so measures that were put in place for a hard Brexit may be required in some cases.[2]

The Loan Market Association ("**LMA**") guidance note on the implications of Brexit, focusses on the impact of the loss of passporting rights on the main "ongoing" financial services envisaged by the LMA facility agreements which UK-based institutions perform in the EU-27, or vice versa. These are, for example, (a) lending; (b) issuing letters of credit or bank guarantees; (c) providing facility agency and security agency services; and (d) providing and running bank accounts.

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[1] For information on the status of Brexit and the implementation period following the passing of the European Union (Withdrawal Agreement) Act 2020 – see our client briefing ***"Brexit: where do we go from here?"*** (February 2020).
[2] For information on the financial regulatory issues, see ***"Brexit snapshot: Financial services"*** (February 2020).

Could a potential finance party, be it as arranger, agent, lender, security trustee or security agent, involved in any of these activities still avail itself of any contractual protections in the finance documents? LMA facility documentation already includes certain contractual devices which may assist with the loss of passporting issues. These include: (i) the ability to transfer interests under facility documentation to an appropriately licensed affiliate; (ii) the ability for an institution to change the branch through which it acts; (iii) any contractual rights to exit the transaction under illegality protections; and (iv) the ability to control the accession of additional members of the borrower group to existing lending arrangements.

At the structuring and drafting stage, parties could consider inserting into finance documents other contractual provisions on a transaction by transaction and jurisdictional basis, including:

(a) tranching structures for multi-jurisdictional groups with different tranches available to different members of the borrowing group based on their location;

(b) fronting structures for lending by a single "fronting" lender with back-to-back funding arrangements with the rest of the syndicate;

(c) amending illegality clauses to extend their application to those instances where a lender is unable to maintain its participation in a loan or facility due to the loss of passporting rights;

(d) expanding facility agent resignation wording;

(e) ensuring greater flexibility for bank accounts to be held with other appropriate institutions (taking account of security and insolvency rules);

(f) more controls on the accession of new borrowers; and

(g) including mechanisms in mandate and commitment letters which allow for a transfer of the commitment to an institution’s affiliate.

Please see ***"Brexit snapshot: Financial services"*** for more information.

LIBOR - What happens to LIBOR as a benchmark rate?

LIBOR is already the subject of reform following the financial crisis in 2008-9 and its use is expected to end in 2021, following the announcement by the Bank of England that it will soon cease to require banks to provide quotations to sustain LIBOR. The Sterling Overnight Index Average (“**SONIA**”) administered by the Bank of England, is the preferred benchmark to replace Sterling LIBOR. It is described as a “nearly risk free reference rate" (“**RFR**”) with its foundation in recent real financial transactions. However, LIBOR is still being used for many transactions while the market is working on how to create and manage a SONIA term rate for longer term financing. That said, ICE Benchmarks Administration Limited ("**ICE**") which administers LIBOR is authorised by the UK's Financial Conduct Authority under the EU Benchmarks Regulation[3] , implemented into UK legislation through amendments to both the FCA Handbook, the PRA Rulebook and secondary legislation, and is registered in the European Securities and Markets Authority's register of administrators and benchmarks.

Where there is a Deal, we expect that, as with the likes of passporting, the UK and EU-27 will work together on cooperation in relation to financial services. However, perhaps alternative RFRs will soon become more accessible, especially if a methodology for a SONIA term rate is accepted by the sterling financial markets. At exit day LIBOR is still an available benchmark albeit it is on the decline and being replaced by SONIA in the derivatives market, while it is slowly being introduced into the syndicated loans market. At IP completion day, it is hoped there will be an agreement in relation to financial services with some equivalent recognition in relation to benchmarks. The Working Group on Sterling Risk Free Reference Rates has announced that its target to end the issue of LIBOR-

[3] 2016/1011

based cash products is the end of Q3 2020 and later in Q1 it expected that market makers will start to change market convention for sterling interest rates swaps from LIBOR to SONIA.

Absent any agreed arrangements to be reached during the UK-EU27 discussions on financial services scheduled to be concluded by June 2020, ICE's authorisation under the Benchmarks Regulation could cease to be valid at IP completion day. However, the transitional provisions of the Benchmarks Regulation[4] provide that benchmarks of administrators from third countries can continue to be used in the EU-27 if already used as a reference for financial instruments and finance contracts. ESMA has announced that admnistrators could apply for an extension by 1 January 2020. Nonetheless, it seems likely that ICE will need to consider the equivalence, recognition and endorsement routes that are available under the Benchmarks Regulation for third party administrators to enable their benchmarks to continue to be used in the EU-27 and by EU participants. ICE is also one of the administrators of SONIA, the preferred replacement for LIBOR.

Increased costs – Will this clause still operate?

Under an increased costs clause using LMA or similar wording, a finance party can recover from the borrower group the amount of any increased cost incurred as a result of compliance with a change in law or regulation which occurs after the date of the facility agreement.

There are changes pending to the EU legislation on regulatory capital as a result of CRR, CRD V and MLD5 (the latter was due to be transposed into national legislation by 10 January 2020). It is possible some borrowers will try to exclude from the scope of this clause increased costs resulting from the 2018 Act, its subordinate legislation, and the 2020 Act, so they would not have to meet such additional costs where they arise due to Brexit. As this may relate to the status of the lender, some of the potential solutions discussed under the section above on "Regulatory and passporting issues", or the right to prepay and refinance that particular lender's loan, could be practical ways to cover such unexpected costs following Brexit.

Sanctions drafting – Should we still use the same sanctions following Brexit?

In transactions with an international element, parties should consider whether sanctions are relevant and, if so, which sanctions clauses should be included in commercial or finance documents. While some financial institutions have their own preferred wording, the LMA sanctions drafting mainly appears in the LMA developing markets documents. In each case, it is usual for the obligor(s) to agree to comply with sanctions imposed by the EU, the United Nations, the United States of America ("**US**") and the home nation (assuming the UK is the home nation, then the UK).

UK sanctions which would ordinarily derive from UN and EU acts can already be made under the Sanctions and Anti-Money Laundering Act 2018 which gives the UK Parliament the power to impose sanctions directly. This was introduced so that, notwithstanding the progress, or lack of it, on Brexit, the UK has the ability to impose sanctions under its own primary legislation in the fight against terrorism, money laundering and international crime.

As the US's views start to diverge from those of other members of the international community on sanctions, we are already seeing changes in contractual terms. Where compliance with a sanctions clause in an agreement which includes US sanctions, could cause a breach of other international or national sanctions or a breach of the EU Blocking Regulation, we are seeing a carve-out on compliance in agreements. The EU Blocking Regulation aims to outlaw compliance with certain specified measures under US sanctions in relation to Iran, Cuba, Libya and Syria. This carve-out is not included in all documentation, but since the European Commission announced an update of the Blocking Regulation in August 2018, it is more much common.

So, the UK will be in a position to impose its own sanctions under primary legislation in addition to sanctions under UN rules. In transactions, finance parties in deciding whether to include contractual undertakings, representations and events of default on sanctions usually consider a number of issues: (i) the parties; (ii) the jurisdictions of

[4] Article 51(5)

establishment or incorporation of the entities to the transaction; (iii) performance and place of performance; and (iv) payment. Brexit will prompt a thorough look at remedies needed in finance transactions taking account of the changing political climate in response to rogue states, international crime and money laundering.

Contractual recognition of bail-in clauses – How will things change after Brexit?

Article 55 of the EU Bank Resolution and Recovery Directive ("**BRRD**") deals with bail-in clauses that allow EEA financial regulators to exercise write down and conversion powers under BRRD implementation legislation. It applies only to documents governed by the laws of non-EEA countries. On exit day, even under the Deal, the UK will become a non-EEA country, as the option for the UK to remain within the EEA is not on the table. In April 2019, the LMA issued amended guidance and "bail-in" wording covering the UK pre- and post-Brexit, where the UK will be classed as a third country. In the latter case, the rules will be applied along the same lines as the BRRD as implemented into law in the UK.

There are moves in other parts of the world to include similar provisions in contracts so that borrowers accept that regulators can act to save financial institutions by altering the rights of borrowers. Indeed, even pre-Brexit, the practice has developed in some sectors to include "bail-in" language in an English law facility agreement, whether or not there is a specific legal requirement to do so, and in this way it is becoming a standard clause. Following Brexit, the concept and the contractual provisions are very likely to continue as part of a wider movement following the wake of the financial crisis. References to specific implementing legislation may however, be different to reflect the position after the IP completion day.

Governing law - Do we need to change the governing law in our finance documents?

No. The same position will be maintained during the implementation period. Until 31 December 2020, EU law implemented or directly applicable will continue to apply in the UK.

If no agreement can be reached on the future relationship by IP completion day it is likely that the courts of the EU-27 would continue to give effect to English law in the same way as they do currently. The Rome I Regulation requires EU member states to give effect to the parties' choice of law, regardless of whether that law is the law of another EU member state or not. English contract law is largely unaffected by EU law and the UK's withdrawal from the EU should not, of itself, affect the perceived benefits of a choice of English law (including its commercial orientation and its emphasis on upholding and respecting parties' commercial bargains).

Jurisdiction clauses - Do we need to amend the jurisdiction clause in our finance documents?

Most LMA Facility Agreements and other finance documents are drafted using asymmetric jurisdiction clauses. These allow finance parties to take proceedings in any court of competent jurisdiction but restrict the rights of borrowers and obligors to taking proceedings in English courts. Within the EU member states, English law jurisdiction and judgments are supported by the Recast Brussels Regulation which provides recognition of jurisdiction and judgments throughout the EU giving reciprocity between the EU member states.

The UK is withdrawing its request to accede to the Hague Convention on Choice of Court Agreements 2005 ("Hague Convention"). At that stage the UK would rely on the terms of the Withdrawal Agreement that a judgment granted before the IP completion day would be recognised and enforceable under the Recast Brussels Regulation, even if enforced after the IP completion day. The UK may also issue notice to accede to the Hague Convention as an independent signatory.

However, if no future arrangement can be agreed before IP completion day, it could affect the enforceability of judgments of English courts as the UK will lose its reciprocity with the EU-27. The UK could become an independent signatory to the Hague Convention, to which the EU is already a member. However, it is likely that the UK would only become an independent signatory after IP completion day, so there could be a short period when the UK does not have the rights afforded to contracting states. The Hague Convention provides for the recognition and enforcement of judgments given by courts of contracting states selected in an exclusive jurisdiction agreement.

Documentation in finance transactions more often than not does not use exclusive jurisdiction clauses, but instead uses asymmetric jurisdiction clauses. For asymmetric jurisdiction clauses which fall outside the remit of the Hague Convention, the EU-27 would have to look to the national laws of the relevant state in relation to recognition of the jurisdiction of English courts and enforcement of judgments issued by English courts. In addition, some contracts are excluded from the scope of the Hague Convention's protection, for example, agreements for carriage of passengers and goods, marine pollution, limitation for marine claims and salvage, relevant for transport, trade and shipping.

At this stage, the LMA is reviewing its documentation and has not published any alternative drafting for jurisdiction clauses.

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