Weil

Brexit
A structured finance perspective

The result of the UK's referendum to leave the European Union has given rise to enormous uncertainty. At the moment, the European structured finance market operates across numerous jurisdictions and is subject to extensive EU legislation. UK related transactions form a significant component of the market. Accordingly, Brexit could potentially have a significant impact on the market.

The initial days after the referendum have seen reduced market activity, which has perhaps been exacerbated by the onset of the traditional market slowdown in the summer months. On a positive note, work has continued on many transactions which were being planned before the referendum vote and public deals continued to be priced at acceptable levels. Nevertheless, it is expected that the uncertainty will result in market players withdrawing or delaying transactions with a UK component until there is more clarity as to the future framework for the EU/UK relationship, resulting in a lower overall transaction volume for the time being.

Several of the factors that will have an impact on the structured finance market are ones which will affect finance and business generally, about which many column inches have already been written. In this note we therefore concentrate on matters which are more specific to structured finance. From the perspective of our practice, the impact of the referendum result can be broken down into legal issues relating to contracts, questions of investor disclosure and regulatory concerns.

Immediate Considerations

As has been well rehearsed, the decision to leave the EU has not as yet had any legal effect. As such, there has been no change to the regulatory environment in which deals take place. Subject to the points below, we would not anticipate that immediate action needs to be taken by parties to existing structured finance transactions.

Legal Contractual Issues

In terms of English law contractual issues, in the structured finance arena it is unlikely that the referendum outcome has had any effect on legal agreements for transactions already entered into. As has also been covered widely elsewhere, the main provisions under consideration from this perspective related to Material Adverse Change, Market Disruption, Force Majeure and Illegality. The position in each case very much depends on the exact wording of the relevant provisions. However, in common with the position across the business world generally, the typical forms of such clauses found in our sector would not have been triggered so far. Thus, there is little concern among market players about existing contracts for the time being.

The next question is therefore whether contracts currently being negotiated should include any provisions to deal with the situation created by Brexit. As yet few parties have sought to add or change any provisions related to Brexit. This is largely because no one can tell what the exit arrangements and the resultant legal environment will look like. It is also noted that the Loan Market Association and ISDA, trade bodies which produce documentation that is influential in the structured finance market, have yet to propose any recommended contractual changes specifically related to Brexit.

We can however foresee an increase in requests from certain parties to insert into contracts specific termination rights related to regulatory change. For example, a bank counterparty to a swap contract may seek the ability to exit a transaction if the costs to the bank of holding its position becomes prohibitive following a change of regulation which can be said to be related to Brexit. In our experience, as yet, such requests have been of a limited scale.

Clearly, legal agreements entered into once the framework for Brexit is known will need to reflect the new environment. The Brexit related issues under English contract law more widely will impact equally on structured finance transactions. The future position on such issues will depend on any replacement arrangements struck between the UK and the EU on the relevant matters. These include governing law or jurisdiction clauses covering choices of law and dispute resolution forum. Those clauses are currently covered by the Recast Brussels Regulation and the Rome I and II regulations, which would cease to apply if the UK leaves the EU.

Investor Disclosure

The same points relating to investor marketing and distribution legislation (such as prospectus and listing regulations) generally will apply to public bond issuances in the securitisation market. In relation to such transactions coming to market, it will be advisable to consider having a risk factor related to the possible effects of Brexit in the bond prospectus (particularly in deals with a strong UK nexus). The forms of disclosure seen in the market at present vary from relatively short and simple risk factors to lengthy attempts at describing various scenarios which could arise from Brexit. Our view is that the former method, using clear and wide language, is preferable to attempting to describe every manifestation of the possible impact. In our experience, the brief form of disclosure is also the more common approach in the market.

Financial Regulation

One of the biggest question marks arising from the Brexit vote relates to the landscape in financial services and "passporting" – the system under which firms authorised in one EU jurisdiction can operate on a cross border basis in other Member States. In the CLO market many collateral managers are authorised in the UK to provide investment advice or portfolio management services, ultimately pursuant to the Markets in Financial Instruments Directive ("**MiFID**"). Typical European CLO structures involve collateral managers providing those services to debt issuing vehicles situated in Ireland or the Netherlands. Thus, it needs to be considered the extent to which such arrangements could continue if, after Brexit, passporting rights were no longer available to a UK collateral management firm and no equivalent rights were granted in the exit arrangements. To this end, under current legislation it is not generally necessary for the collateral manager to have a MiFID derived authorisation to provide CLO services in Ireland if the collateral manager has no head or registered office or branch in Ireland. However, a collateral manager does need MiFID recognition to provide such services in the Netherlands. We therefore expect forthcoming CLOs structures with UK collateral managers to favour Irish issuers over Dutch ones.

A thornier issue relating to MiFID authorisations concerns transactions which currently use the sponsor route with regard to the EU risk retention rules where the sponsor is UK authorised. The definition of "sponsor" relies on definitions under EU legislation related to MiFID and accordingly there is a risk that UK authorised entities cease to qualify as 'sponsors' for European risk-retention purposes. Notably, in the CLO market many transactions rely on UK collateral managers retaining as sponsor to satisfy the rules. This area is therefore of concern to the CLO market given that, regardless of the UK position following Brexit, transactions will still need to comply with EU regulations in order to access investors in the EU.

In this regard, we perceive that parties will increasingly look to use the originator route to meet the risk retention rules because under current legislation there is no requirement for "originators" to be MiFID authorised. There are various options for originator structures for existing and new transactions, including alternatives that may also satisfy US risk retention rules. Weil was an early leader in the development of originator structures for CLOs and is currently working with a number of clients on these solutions.

It should be noted that at the present time a proposed EU securitisation regulation is under development. During this process, the European Parliament put forward amendments to the draft regulation which, while not entirely clear, suggest that it may become necessary for originators to be EU regulated entities. While the proposed regulation is not intended to apply retrospectively, if such requirement is adopted, future originator structures involving UK risk retention holders may also be impacted in a similar way to that described above for sponsor structures. However, market participants are strongly lobbying against these suggestions and, given the number of wider issues those changes would cause, are hopeful that such amendments will not come to pass.

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