

LSE and ESMA Issue Guidance on the Potential Impact of a “No-Deal Brexit”

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INTRODUCTION

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The European Securities and Markets Authority (“ESMA”) has advised EU asset managers, issuers and other market participants that they will be required to trade shares in UK-listed companies with sufficient liquidity in the EU on EU trading venues if the UK leaves the EU without a formal withdrawal agreement in place. ESMA thus becomes the latest regulatory agency to issue guidance on the potential impact of a “no-deal Brexit” scenario: In December 2018, the London Stock Exchange sought to provide clarity to market participants, and in February 2019, the UK Financial Conduct Authority (the “FCA”) proposed amendments to the FCA Handbook to correct “deficiencies” in the UK’s regulatory framework caused by Brexit¹.

Almost three years after the UK voted to leave the EU in the referendum held on 23 June 2016, how the exit will be realised is still uncertain, with the UK Parliament being unable to agree either to Theresa May’s withdrawal agreement or on any alternative proposals. Although the EU Council agreed on 22 March 2019 to extend the period under Article 50 to 12 April 2019 to give the UK Parliament more time to reach an agreement, the result of this impasse has led the EU to dial-up its contingency plans for a “no-deal Brexit” scenario. ESMA’s [public statement](#) of 19 March 2019, which provides guidance on the impact of a “no-deal Brexit” on the trading obligation for shares, is the latest move from the EU to mitigate the effect of a “no-deal Brexit”.

We have summarised below the guidance issued by the London Stock Exchange and ESMA, as well as the implications of such guidance for dual-listed companies, investment firms and other market participants.

¹ See the FCA’s policy statement PS19/5 (<https://www.fca.org.uk/publication/policy/ps19-05.pdf>).

LONDON STOCK EXCHANGE HARD BREXIT IMPACT ASSESSMENT

On 11 December 2018, the London Stock Exchange published a [note](#) summarising its assessment of the impact of a “hard” Brexit on the assumption that the London Stock Exchange would not have MiFID authorisation and that the UK would not be granted equivalence status under article 23 of the Markets in Financial Infrastructures Regulation (“MiFIR”). The assessment focused on, amongst other things, the applicability of trading obligations under MiFIR, access to the London Stock Exchange markets and passporting rights for prospectuses.

Share Trading Obligations under MiFIR

Under article 23 of MiFIR, the “share trading obligation” requires EU investment firms regulated by the Markets in Financial Infrastructures Directive (“MiFID II”) to trade shares on EU regulated markets, multilateral trading facilities (“MTFs”) or systematic internalisers, or on a third country trading venue with equivalence status. The London Stock Exchange expressed its hope that, in the event of a “no-deal Brexit” scenario, the EU will grant the UK equivalent status.

In the absence of such equivalence status, however, EU investment firms, including brokers, would not be permitted to execute trades on the London Stock Exchange in UK-listed securities that are also dual-listed (or admitted to trading) on an EEA trading venue and that are subject to the share trading obligation. However, the London Stock Exchange is of the view that if the security is solely listed on the London Stock Exchange, then investment firms should be able to continue to trade such securities through the London Stock Exchange.

Access to London Stock Exchange Markets

UK and non-EEA firms who are members of the London Stock Exchange would not be able to use an EEA firm as their clearing or execution broker following a “no-deal Brexit”. Such member firms should develop contingency plans and notify the London Stock Exchange of such plans.

EEA member firms and their clients may not be able to continue to trade directly on the London Stock Exchange’s trading services as active direct members of the London Stock Exchange following a “no-deal Brexit”. Such firms should also develop contingency plans, such as establishing a UK subsidiary which will then need to apply for authorisation from the FCA and London Stock Exchange membership.

Passporting Rights for Prospectuses

On 21 November 2018, the UK Government confirmed that prospectuses approved by an EEA competent authority that have not been passported into the UK before the UK's exit from the EU would not automatically benefit from passporting rights into the UK market following a "no-deal Brexit". As a result, an issuer seeking to list on both the London Stock Exchange and an EEA regulated market would be required to obtain approval of the prospectus from the FCA as well as from an EEA competent authority.² The London Stock Exchange expects that the content requirements for a prospectus in the UK would remain the same as those required in the EU, while the UK Government has confirmed³ its intention to issue an equivalence decision to allow issuers to prepare financial accounts under EU-adopted IFRS accounting standards for financial years starting before the day on which the UK leaves the EU. Financial accounts for financial years starting after the UK's exit should be prepared in accordance with UK-adopted IFRS.

The London Stock Exchange is of the view that a hard Brexit will have minimal impact on admissions to AIM and on issuers listing solely on the London Stock Exchange.

ESMA GUIDANCE

On 19 March 2019, ESMA published a public statement to clarify to market participants its position on the applicability of the share trading obligation under article 23 of MiFIR in the case that equivalency status is not granted to the UK. As noted above, the London Stock Exchange is hopeful that, in the event of a "no-deal Brexit" scenario, the EU will grant the UK equivalent status.

If the UK were to leave the EU without a deal on 12 April 2019, the share trading obligation would apply to all shares traded on EU trading venues, as well as UK-listed shares⁴ that are deemed to have sufficient liquidity in the EU under MiFID II (based on 2018 trading volumes in the EU27).⁵ Market participants, including European banks and

² <https://www.gov.uk/government/publications/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019-explanatory-information>.

³ <https://www.gov.uk/government/publications/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019-explanatory-information>.

⁴ For the purposes of the share trading obligation, UK shares are shares with an ISIN starting with the prefix "GB".

⁵ UK shares that have their main pool of liquidity in the UK and that do not qualify as "liquid" under MiFID II are considered to be traded in a non-systematic, ad hoc, irregular and infrequent way in the EU27 and, therefore,

buy-side firms, will as a result be unable to trade such listed UK shares, even if those are dual-listed on another EU exchange, or EU shares on UK-based trading venues. ESMA has published a [list](#) of over 6,200 companies (including 14 shares listed in the UK with liquidity deemed to be sufficient in the EU) whose shares would be affected by this move.

ESMA has stated that its “approach seeks to limit potential market disruption while also ensuring Article 23 MiFIR is adequately and consistently applied across the EU”⁶. In response, the FCA has expressed its concern that ESMA’s approach may limit firms “to trading certain shares only in either the UK or the EU or in some cases be caught by overlapping obligations” between the UK and the EU, which “has the potential to cause disruption to market participants and issuers of shares based in both the UK and the EU, in terms of access to liquidity and could result in detriment for client best execution”.⁷

Dual-listed companies and their investors may be particularly concerned by ESMA’s clarification; the London Stock Exchange has previously noted that in such a scenario, EU investment firms will face restrictions forcing them to buy and sell such shares on the EEA trading venue or equivalent third country trading venue “even if liquidity is thin and the price is less favourable”.⁸ As a result of these restrictions, EU investment firms run the risk of breaching MiFID II’s best execution rules that require them to secure the best price for their trades of EU-listed securities.

WHAT HAPPENS NEXT

There are still a number of possible scenarios for the UK’s exit from the EU and there is still no certainty as to what will happen next: the UK Parliament may vote in favour of Theresa May’s withdrawal agreement negotiated with the EU in a third “meaningful vote”, thereby avoiding a “hard Brexit”; a second referendum may be held to ask the British public to make a choice between a “no-deal Brexit”, the withdrawal agreement and remaining in the EU; or the EU may even agree to a significantly longer extension to the period under Article 50 beyond the revised exit date of 12 April 2019. Equally, a “no-deal Brexit” remains a distinct possibility, and the EU Commission’s decision on whether to grant the UK equivalence status under MiFID II in such a scenario is ultimately a political one.

fall outside the scope of the share trading obligation under article 23 of MiFIR and can continue to be traded on UK venues.

⁶ <https://www.esma.europa.eu/press-news/esma-news/esma%E2%80%99s-application-trading-obligation-shares-following-no-deal-brex-0>.

⁷ <https://www.fca.org.uk/news/statements/fca-statement-share-trading-obligations>.

⁸ <https://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/lseplc-hard-brex-impact-assessment.pdf>.

ESMA has noted that it may adjust its approach if “the timing and conditions of Brexit change” and it will consider, “in light of possible market developments”, reviewing its approach within 12 months from the date the UK leaves the EU with no deal. The London Stock Exchange and the FCA, meanwhile, have signalled their willingness to engage constructively with ESMA and other European regulatory authorities to ensure the disruption caused by a possible “no-deal Brexit” is kept to a minimum.

In light of the guidance issued to date, however, we recommend that investment firms and dual-listed issuers continue to implement contingency plans in the event that the UK leaves the EU without a deal and the EU Commission decides not to grant the UK equivalence status under MiFID II.

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Please do not hesitate to contact us with any questions.

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