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# Brexit – Implications for securitisation & debt capital markets transactions involving Irish SPVs

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On 23 June 2016, the UK took the historic decision to leave the European Union. In general, from an Irish perspective, it was an unexpected and regrettable outcome for our closest neighbour and most important trading partner. While the impact of Brexit is expected to be profound for the Irish economy, the departure of the UK from the EU will bring opportunities for Ireland, particularly for the Irish financial services industry.

However the full impact of Brexit on the European securitisation and capital markets cannot be considered until the UK government agrees how it will achieve an orderly exit with the EU. UK managers, arrangers, sponsors and originators are already using Irish vehicles as platforms for structured products and capital markets transactions and can continue to do so under the current regime if and until the formal exit actually occurs. As such, it is "business as usual" until the British government triggers Article 50 and commences negotiations on a UK exit with the remaining 27 member states of the EU.

This client advisory considers potential issues for securitisations and capital markets transactions structured through Irish domiciled SPVs and highlights the opportunity for Ireland as a centre of excellence for issuer domicile and debt listings following Brexit.

## The macro impact of Brexit on securitisation and debt capital markets transactions

In the immediate aftermath of the result, it has been reported that spreads were out across all securitised asset classes and, as the enormity of the challenge that the EU and the UK becomes apparent, the result of the Brexit vote may continue to impact spreads for the remainder of the year.

Analysts and investors have widely commented that they also expect to see reduced issuances in the primary market over the next few months. Specific products such as CP, ABCP or auto ABS may weather the storm better than others though because they are short dated and will mature prior to any formal action being set in motion.

From a medium to long term, the full implications of Brexit will take years to unfold. It appears that the EU leaders are adopting a hard-line and will not allow the UK to cherry-pick certain EU laws while maintaining full access to the single market. The UK will need to retain or replicate much of EU-derived legislation to allow the banking and capital markets industry to continue to function in a meaningful way. Any reduction in regulation would have to be weighed against the restriction of access to the EU's single market.

In a complete exit scenario, UK firms could lose their status as an EU "credit institution", "investment firm" or "insurance undertaking and, depending on the new UK regime, would have to become third country firms ("TCFs"). They could potentially be in no better position to access the EEA market than a US firm albeit that a large proportion of EU legislation such as AIFMD, MIFIR/MIFID II etc have been hardwired to harmonise the position of TCFs.

We are likely to see intense negotiation over these issues in the coming months while the EU faces an existential crisis as the paradigm begins to shift with the rise in nationalist and anti-globalisation movements across the bloc.

Clients should refer to our *"Brexit – Regulation of Financial Services Providers"* and *"Regulation of MiFID firms"* client advisories for further information on the Irish regulatory environment for regulated firms.

## Potential regulatory impact on transactions structured through Irish SPVs

The regulatory impact of Brexit on the vast majority of transactions structured via Irish vehicles should be limited for the following reasons:

- Ireland will remain a member of the European Union and the OECD;
- Ireland's extensive double taxation treaty network with over 72 countries (including the UK) will remain in place – see our *"Brexit – Implications on Tax"* advisory for more information;
- the ability of an Irish issuer to passport a prospectus approved by the Central Bank of Ireland to other EU countries will remain unaffected (save for, perhaps passporting into the UK in a post-exit scenario).

## Impact on CLO Market & Risk Retention

A key concern for managers and investors in the CLO space is the future viability of structures where UK domiciled MiFID sponsors hold the risk retention piece in the event that passporting privileges are revoked following a formal exit by the UK from the EU where it does not remain as an EEA or EFTA member. While conceivably the UK could remain in the EEA which would allow managers to retain these privileges, it would have to accept the four freedoms of the EU including the free movement of labour which may not be feasible.

Under current Irish law, managers located outside of the EU can provide investment services to Irish SPVs do not need to have a MiFID licence provided the manager has no head or registered office or branch in Ireland. As such, for European CLOs managed by UK collateral managers, it is possible that the UK collateral manager could continue to be used where the CLO is structured through an Irish SPV, especially where they can come up with an originator based solution to risk retention (as to which see below).

Some commentators are confident that the CLO market is resilient and the UK will establish a risk retention model to permit EU wide distribution. Alternatively, it could agree a soft exit that allows the UK to remain a part of the single market whereby UK firms would retain their ability to passport. Nevertheless, as a hedge against this, some managers are looking at the possibility of establishing a sponsor entity elsewhere in the EU. Clients should refer to – *"Brexit – Regulation of MiFID firms"* client advisory in this context.

While there is no immediate need to amend any transactions where UK collateral managers act as sponsor retention holders, existing CLOs which are risk retention compliant in this manner will need to assess their options for remaining compliant in a post-exit scenario in order to avoid adversely affecting the value of the securities in the secondary market. Obviously, any amendments to the risk retention piece will also have to comply with the proposed STS Regulation too.

## Capital Markets Union (CMU)

If the UK were to leave the European Union, it is expected that the Capital Markets Union project would still continue as a viable project albeit at a slower pace as it would lose many important voices in the City of London and Bank of England who have been strong supporters of the securitisation industry including, of course, Lord Hill the recently resigned EU Commissioner for financial services.

## ECB Quantitative Easing & Collateral Rules for ABS

In light of developments in Italy and elsewhere, we are likely to see the ECB expanding its quantitative easing programme. Recently it has been buying up to €80bn worth of bonds -- primarily government -- on a monthly basis. This is likely to continue and could increase in the weeks and months ahead. Also, following the recent German constitutional court judgment which essentially confirms the ECJ's ruling that the Outright Monetary Transactions programme is legal and within the ECB's mandate, officials could also decide to unwrap the OMT from its box and start buying short-term government debt in unlimited quantities. In that regard, the ECB has openly stated that it is ready to provide additional liquidity to the financial markets but considers the euro area banking system to be resilient in terms of capital and liquidity.

As regards the impact on eligible collateral for the ECB general and temporary frameworks, it is expected that UK governed collateral will no longer be eligible post-exit as assets must be acquired by the issuer by way of a true sale under the law of an EU member state. Accordingly, unless a true sale can be effected under the laws of another member state, EU banks will have to exclude UK collateral from their eligible pools.

## Solvency II

As an EU Member State Ireland has implemented Solvency II fully (and does not have to rely on a "Solvency II equivalent" regime). The departure of the UK from the EU does not impact Ireland's position in this respect.

From a capital markets perspective, our view is that Brexit should not impact on ILS transactions structured via Irish SPVs.

Clients should refer to our "*Brexit - Implications for the ILS Markets*" client advisory in this context.

## Choice of Law, Submission to Jurisdiction & Recognition of Judgments

Council Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations ("Rome I"), Council Regulation (EC) No 864/2007 of 11 July 2007 on the law applicable to non-contractual obligations ("Rome II"), Regulation (EU) No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the "Recast Brussels Regulation") have force of law in Ireland and typically recognise the choice of law and submission to jurisdiction by parties to an agreement.

It is likely that Rome I, Rome II and Recast Brussels Regulation will cease to have effect in the UK in respect of new transactions following a formal clean break from the EU.

The existing regimes will continue to apply within the remaining EU member states and therefore the courts of other EU Member States will still respect the parties' choice of law even if it is a law outside the EU (e.g. in a scenario where an Irish issuer chooses English law as the governing law of an agreement, an Irish court would recognise this as a valid choice).

The impact of Brexit on the submission to jurisdiction clauses and recognition of English judgments across the EU (and vice versa) is not clear yet. The approach to be adopted by the UK will dictate whether it will accede to the Lugano Convention, the Hague Convention on Choice of Court Agreement which gives effect to exclusive jurisdiction agreements or other harmonising international conventions.

We will issue a separate client advisory on this issue when the proposed exit path and EU response becomes clearer.

## Listing on the Irish Stock Exchange

Several issuers have chosen both the Global Exchange Market and the Main Securities Market of the Irish Stock Exchange. Given Ireland's commitment to remain a member of the EU, we anticipate that "business as usual" will apply to all existing issuers who have listed their securities on the Irish Stock Exchange. Indeed we expect some issuers to migrate their listing from the London Stock Exchange to the Irish Stock Exchange where they have listed in London for purposes of availing of EU wide passporting.

## Ireland as the premier domicile of choice for securitisation and debt capital markets issuers

The outcome of the Brexit referendum should have no impact on Ireland as the dominant jurisdiction for securitisation and capital markets transactions in Europe. The decision of the UK to depart from the EU means that Ireland remains the only common law, native English speaking jurisdiction within the European Union and, as such, is well placed to retain its position as the domicile of choice for these transactions.

Many domestic UK ABS/CMBS/RMBS transactions have, in recent years, been structured via UK domiciled SPVs – these transactions may migrate to Ireland if the UK is unable to access international EU markets after leaving the single market.

## Key Contacts

If you have any concerns about the impact of Brexit on your existing transactions structured through Ireland or would like further information, please contact any of the following members of our Brexit team.

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This advisory is part of a series of client advisories on the potential impact of Brexit prepared for clients of Walkers' office in Ireland. The full series may be found in the Brexit section of our website.