

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

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## Introduction

The European Securities and Markets Authority (“ESMA”) and the London Stock Exchange (the “LSE”) have revised their respective guidance to EU asset managers, issuers and other market participants on the potential impact of a “no-deal Brexit” as they continue to work towards minimising market disruption in the event that the UK leaves the EU without a formal withdrawal agreement in place. The UK is currently due to leave the EU on 31 October 2019, unless the UK government requests, and the EU grants, and extension to the date on which the UK will leave the EU.

Much has changed to the political landscape of the UK since we last discussed the guidance of the London Stock Exchange and ESMA in our client update, [LSE and ESMA Issue Guidance on the Potential Impact of a “No-Deal Brexit”](#), on 27 March 2019: Theresa May stood down as Prime Minister following the failure to obtain the UK Parliament’s approval on her withdrawal agreement negotiated with the EU, to be replaced by Boris Johnson, who, as a leading figurehead of the “leave” campaign during the June 2016 referendum, has upped the rhetoric of leaving the EU with or without a deal with the EU. On 9 September 2019, the UK government prorogued the UK Parliament until 14 October 2019, effectively reducing the time available for the UK Parliament to reach a consensus on Brexit. Also on 9 September 2019, the UK Parliament passed legislation to require the UK government to request the EU to grant an extension to Article 50 until 31 January 2020; however, there is no guarantee that the EU would agree to such an extension and, given the lack of an apparent consensus in the UK Parliament for any alternatives, the manner of the UK’s exit from the EU and the UK’s subsequent relationship with the EU remain uncertain more than three years after the UK voted to leave the EU in the referendum held on 23 June 2016.

We have summarised below the revised 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.

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## ESMA Adjusts Guidance on EU Share Trading Obligation

On 29 May 2019, ESMA published a [public statement](#) amending its guidance of 19 March 2019 on the application of the EU share trading obligation (“EU STO”) for shares under article 23 of the Markets in Financial Instruments Regulation (“MiFIR”) in the absence of equivalency status being granted to the UK. The EU STO requires EU investment firms regulated by the Markets in Financial Instruments 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.

As we noted in our client update of 27 March 2019, ESMA originally stated that the EU STO would apply to all shares traded on EU trading venues and to UK-listed shares<sup>1</sup> that are deemed to have sufficient liquidity in the EU under MiFID II, and identified 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 interpretation. In response to concerns raised by some stakeholders about its initial guidance, ESMA has adjusted its approach to apply the EU STO only to shares whose ISINs have a prefix corresponding to an EU27 Member State, Iceland, Liechtenstein or Norway. UK-listed shares, therefore, will be outside the scope of the EU STO following a “no-deal Brexit”. ESMA has stated that this adjustment is designed “to minimise disruption and to avoid overlaps” with the scope of the UK share trading obligation.

The FCA has expressed concern that ESMA’s revised approach could still cause significant disruption to investors and market participants, in particular to dual-listed companies, many of whom have shares with EU27 ISINs that are both listed and have their main or only significant centre of market liquidity, on UK markets.<sup>2</sup> In its opinion, the ISIN carried by a share should not determine the scope of the EU STO. There is a risk that ESMA’s revised approach would still place undue restrictions on an EU investment firm’s access to investors, and breaches of MiFID II’s best execution rules that require brokers to secure the best price for their trades of EU securities are possible.

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## Update to the London Stock Exchange’s Hard Brexit Impact Assessment

On 5 September 2019, the London Stock Exchange updated its [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 and the London Stock

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<sup>1</sup> For the purposes of the EU STO < UK shares are shares with an ISIN starting with the prefix “GB”.

<sup>2</sup> FCA May response, 29 May 2019 (<https://www.fca.org.uk/news/statements/fca-update-share-trading-obligations>).

Exchange would not be granted equivalence status under article 23 of MiFIR. While we note that on 11 September 2019 the Hong Kong Exchange and Clearing made a £32 billion bid to acquire the London Stock Exchange, it is unlikely that the offer or any subsequent successful acquisition will change the London Stock Exchange's assessment. We discuss below the London Stock Exchange's latest position on the EU STO under MiFIR, access to the London Stock Exchange markets and passporting rights for prospectuses.

### **Share Trading Obligations Under MiFIR**

Similar to the FCA's response to ESMA's revised guidance, the London Stock Exchange expressed its concern that the scope of the EU STO, as applied by ESMA, will continue to include shares with EU ISINs that have significant liquidity on UK markets, including the London Stock Exchange. The resulting conflicting obligations may inadvertently affect market participants, especially EU investment firms, when managing their portfolios and seeking to achieve "best execution".

The EU STO does not extend to cover depositary receipts, including depositary receipts over underlying EU shares, and so such securities are not affected by ESMA's revised guidance.

To avoid such potential market distortion, the London Stock Exchange continues to work with its European partners in seeking the granting of equivalence status to the UK and the London Stock Exchange. In theory, the implementation of MiFID II and MiFIR in the UK (which will remain in effect in the UK immediately following a "no-deal Brexit") should pave the way towards an equivalence determination from the EU, and equivalence decisions have already been confirmed for several other global exchanges, including ASX, HKEX, Nasdaq and the NYSE. There is no guarantee, however, that the EU will grant the UK such equivalence status in practice.

On a separate note, the London Stock Exchange has suggested that the current restriction on the trading of Swiss securities on EU trading venues, triggered by the EU's decision to remove equivalence status for the Swiss Stock Exchange, will no longer apply in a "no-deal" Brexit scenario. This will be confirmed by the LSE in a market notice.

### **Access to London Stock Exchange Markets**

As we noted in our client update of 29 March 2019, UK firms (and non-EEA firms) that use an EEA firm as their execution broker may not be able to trade all shares admitted to trading on the London Stock Exchange through that broker following a "no-deal Brexit". Such member firms should continue to develop and finalise their contingency plans (if not already implemented) and notify the London Stock Exchange of such plans.

EEA member firms from Germany, Italy and the Netherlands that currently trade through a UK branch can continue to trade on the London Stock Exchange, since the London Stock Exchange has obtained certain licences and dispensations in such jurisdictions to be able to continue to offer membership to firms located in those jurisdictions. No licensing requirements on the London Stock Exchange are expected either in France, Cyprus, Denmark, Ireland, Luxembourg, Spain and Sweden, which if confirmed would allow London Stock Exchange membership to be available to firms located in any of these designated EEA Member States. If an EEA member firm from any of these designated EEA Member States does not have a UK branch, then they must ensure that their systems can provide any necessary transaction reports to the London Stock Exchange, who will in turn report such transactions executed through the facilities of the London Stock Exchange to the FCA. Such EEA member firms should also consider their obligations under the EU STO, as well as any other applicable obligations from their membership of the London Stock Exchange.

If an EEA member firm is seeking access from a non-designated EEA Member State, then they 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", and should continue, therefore, to develop and finalise their contingency plans.

### **Passporting Rights for Prospectuses**

As confirmed by the UK government on 21 November 2018, a "no-deal Brexit" will automatically terminate the benefit of passporting rights for prospectuses approved by EEA competent authorities into the UK market and vice versa. Issuers seeking to list on both the London Stock Exchange's Main Market and an EEA regulated market must, therefore, seek approval from the FCA and the relevant EEA competent authority separately.

Since the UK was still an EU Member State when the EU Prospectus Regulation came into force in full across all EEA Member States on 21 July 2019, the UK's requirements on the content of the prospectus are fully aligned with the requirements of the EU Prospectus Regulation and will remain so following a "no-deal Brexit" under the recently-enacted The Prospectus (Amendment etc.) (EU Exit) Regulations 2019. In addition, as we have noted previously, the UK government has confirmed 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.

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## Next Steps for Market Participants

Despite the apparent lack of progress in negotiations between the UK and the EU on the terms of the UK's withdrawal from the EU since the EU's decision to [grant](#) a further extension to the Brexit process under which the UK will leave the EU on 31 October 2019, it is possible that the EU will agree to yet another extension to the Brexit period if asked by the UK to do so (assuming that the UK Prime Minister, Boris Johnson, complies with the requirement to seek such an extension under the European Union (Withdrawal) (No. 2) Act 2019, which received royal assent on 9 September 2019). Equally, with less than eight weeks to go until the UK's automatic exit from the EU under the current arrangements, a "no-deal Brexit" is looking increasingly likely.

This has led to various calls by the EU to stakeholders in the EU27 to prepare for a "no-deal Brexit", which was most recently [reiterated](#) by the EU Commission on 4 September 2019. In light of the revised guidance issued by the London Stock Exchange and ESMA, together with the continuous gridlock of the Brexit process, we recommend that dual-listed companies and investment firms prioritise the implementation of contingency plans in anticipation of a potential "no-deal" Brexit on 31 October 2019.

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Please do not hesitate to contact us with any questions.

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