The International Capital Markets Review

Third Edition

Editor
Jeffrey Golden

Law Business Research

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EDITOR'S PREFACE TO THE THIRD EDITION

As I write the preface to this third edition of *The International Capital Markets Review*, my morning newspaper reports that one of the major global banks, having shrunk its workforce by more than 40,000 employees over the past two years, will now embark on a hiring spree to add at least 3,000 additional compliance officers.

It would be nice if the creation of these new jobs evidenced new confidence that capital markets activity is on the rise in a way that will justify more hands on deck. In other words, capital markets lawyers will have something to celebrate if this bolstering of the ranks was thought necessary to ensure that requisite regulatory approvals and transactional paperwork would be in place for a projected expansion in deal flow.

And, indeed, my morning newspaper also reports a new transaction of some significance, namely, Twitter's filing for a multi-billion dollar international public offering, accompanied by a tweet, of course – but with a true sign-of-the-times disclosure: 'This Tweet does not constitute an offer of any securities for sale'!

Yes, confirmation of an uptick in deal flow – especially 'big deals' flow – would be nice. In the preface to the last edition of this work, I speculated that there were 'signs that any 'big freeze' on post-crisis capital markets transactional work may be thawing'. All the better if the current newspaper reports provide continued and further support for that inference. After all, when our first edition appeared a little over two years ago, the newspapers were saying terrible things about the capital markets.

What is more likely, however, is that this increased staffing aims to cope with regulatory complexity that will now impact the financial markets regardless of any growth and perhaps may even have been designed to slow down the business being done there. That complexity, but also just the scale of recently promulgated new regulation and the practitioner's resulting challenge in 'keeping up' have all encouraged this new third edition. The 8,843 pages of Dodd-Frank rule-making that I reported in my preface to the last edition have now grown to more than 14,000 pages at this time of writing – and approximately 60 per cent of the job remains unfinished. Other key jurisdictions have been catching up. Plus the rules are purposive and aim to change the way things have been done. If compliance and even ethics in the capital markets were ever instinctual, rather than matters to be taught and studied, that is probably a thing of the past.

The thickness of this volume has grown as well because of the increased number of pages and coverage in it. Nine new contributors (Finland, Indonesia, Italy, the Netherlands, the Philippines, Spain, Switzerland, Tanzania and the UAE) and an overview of EU Directives have been added. Banks are lending less to corporates, which in turn are having to issue more to meet liquidity needs. Moreover, with the low interest rate environment of quantitative easing, central banks are encouraging risk-taking rather than hoarding. For investors, risk-free assets have become very expensive. So we see a growing willingness to get off the traditional highway in search of yield. Investment banks are, as a result, often taking their clients (and their clients' regular outside counsel) to difficult, or at least less well-known, geographies.

Having a pool of country experts and jurisdictional surveys that facilitate comparative law analysis can be very helpful in this instance. That is exactly what this volume aims to provide: a 'virtual' legal network and global road map to help the reader navigate varying, and increasingly difficult, terrain to arrive at right places.

There has been much relevant change in the legal landscape surveyed in the pages that follow. However, what has not changed is our criteria for authors. The invitation to contribute continues to go to 'first in class' capital market specialists from leading law firms. I shall be glad if, as a result, the biographical notes and contact details of the contributing firms prove a useful resource as well.

The International Capital Markets Review is not a novel. Impressed I might be, but I would certainly also be surprised by anyone picking up and reading this volume from cover to cover. What I expect instead, and what is certainly the publisher's intention, is that this work will prove a valuable resource on your shelf. And I hope that you will have plenty of opportunities to take it off the shelf and lots of excuses to draw on the comparative jurisdictional wisdom it offers.

Let me again express my sincere gratitude to our authors for their commitment to the task and their contributions. It remains a privilege to serve as their editor and a source of great pride to keep their company in the pages of this book.

Jeffrey Golden
P.R.I.M.E. Finance Foundation
The Hague
October 2013

EDITOR'S PREFACE TO THE SECOND EDITION

It was my thought that we should also include in this second edition of *The International Capital Markets Review* my preface to the first edition. Written less than a year ago, it captures relevant background and sets out the rationale for this volume in the series. The contemporary importance of the global capital marketplace (and indeed you must again admire its resilience), the staggering volume of trading and the complexity of the products offered in it, and the increased scrutiny being given to such activity by the courts all continue. And, of course, so does the role of the individual – the difference that an informed practitioner can make in the mix, and the risk that follows from not staying up to date.

However, I was delighted, following the interest generated by our first edition, by the publisher's decision to bring out a second edition so quickly and to expand it. There were several reasons for this. The picture on the regulatory front is much clearer for practitioners than it was a year ago – but no less daunting. According to one recent commentary, in the United States alone, rule-making under the Dodd-Frank report has seen 848 pages of statutory text (which we had before us when the first edition appeared) expand to 8,843 pages of regulation, with only 30 per cent of the required regulation thus far achieved. Incomplete though the picture may look, the timing seems right to take a gulp of what we have got rather than wait for what may be a very long time and perhaps then only to choke on what may be more than any one person can swallow in one go! Regulatory debate and reform in Europe and affecting other key financial centres has been similarly dramatic. Moreover, these are no longer matters of interest to local law practitioners only. Indeed, the extraterritorial reach of the new financial rules in the United States has risen to a global level of attention and has been the stuff of newspaper headlines at the time of writing.

There are also signs that any 'big freeze' on post-crisis capital markets transactional work may be thawing. In the debt markets, the search for yield continues. Equities are seen as a potential form of protection in the face of growing concerns about inflation. Participants are coming off the sidelines. Parties can be found to be taking risks. They are not oblivious to risk. They are taking risks grudgingly. But they are taking them. And derivatives (also covered in this volume) are seen as a relevant tool for managing that risk.

Most importantly, it is a big world, and international capital markets work hugs a bigger chunk of it than do most practice areas. By expanding our coverage in this second edition to include six new jurisdictions, we also, by virtue of three of them, complete our coverage of the important BRIC countries with the addition of reporting from Brazil, Russia and China. Three other important pieces to the international capital markets puzzle – Belgium, the Czech Republic and New Zealand – also fall into place.

The picture now on offer in these pages is therefore more complete. None of the 24 jurisdictions now surveyed has a monopoly on market innovation, the risks associated with it or the attempts to regulate it. In light of this, international practitioners benefit from this access to a comparative view of relevant law and practice. Providing that benefit – offering sophisticated business-focused analysis of key legal issues in the most significant jurisdictions – remains the inspiration for this volume.

As part of the wider regulatory debate, there have been calls to curtail risk-taking and even innovation itself. This wishful thinking seems to miss the point that, if they are not human rights, risk-taking and innovation are hardwired into human nature. More logical would be to keep up, think laterally from the collective experience of others, learn from the attention given to key issues by the courts (and from our mistakes) and 'cherry-pick' best practices wherever these can be identified and demonstrated to be effective.

Once again, I want to thank sincerely and congratulate our authors. They have been selected to contribute to this work based on their professional standing and peer approvals. Their willingness to share with us the benefits of their knowledge and experience is a true professional courtesy. Of course, it is an honour and a privilege to continue to serve as their editor in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2012

EDITOR'S PREFACE TO THE FIRST EDITION

Since the recent financial markets crisis (or crises, depending on your point of view), international capital markets (ICM) law and practice are no longer the esoteric topics that arguably they once were.

It used to be that there was no greater 'show-stopper' to a cocktail party or dinner conversation than to announce oneself to be an ICM lawyer. Nowadays, however, it is not unusual for such conversations to focus – at the initiation of others and in an animated way – on matters such as derivatives or sovereign debt. Indeed, even taxi drivers seem to have a strong view on the way the global capital markets function (or at least on the compensation of investment bankers). ICM lawyers, as a result, can stand tall in more social settings. Their views are thought to be particularly relevant, and so we should not be surprised if they are suddenly seen as the centre of attention – 'holding court', so to speak. This edition is designed to help ICM lawyers speak authoritatively on such occasions.

In part, the interest in what ICM lawyers have to say stems from the fact that the amounts represented by current ICM activities are staggering. The volume of outstanding over-the-counter derivatives contracts alone was last reported by the Bank for International Settlements (BIS) as exceeding $700 trillion. Add to this the fact that the BIS reported combined notional outstandings of more than $180 trillion for derivative financial instruments (futures and options) traded on organised exchanges. Crisis or crises notwithstanding, ICM transactions continue apace: one has to admire the resilience. At the time of writing, it is reported that the 'IPO machine is set to roar back into life', with 11 flotations due in the United States in the space of a single week. As Gandhi said: 'Capital in some form or another will always be needed.'

The current interest in the subject also stems from the fact that our newspapers are full of the stuff too. No longer confined to the back pages of pink-sheet issues, stories from the ICM vie for our attention on the front pages of our most widely read editions. Much attention of late has been given to regulation, and much of the coverage in the pages of this book will also report on relevant regulation and regulatory developments; but regulation is merely 'preventive medicine'. To continue the analogy, the courts are our 'hospitals'. Accordingly, we have also asked our contributors to comment on any lessons to be learned from the courts in their home jurisdictions. Have the judges got it right? Judges who understand finance can, by fleshing out laws and regulations and applying them to facts perhaps unforeseen, help in the battle to mitigate systemic risk. Judges who do not understand finance – given the increase in financial regulation, the amounts involved, and the considerable reliance on standard contracts and terms (and the need therefore for a uniform reading of these) – may themselves be a source of systemic risk.

ICM lawyers are receiving greater attention because there is no denying that many capital market products that are being offered are complex, and some would argue that the trend is towards increasing complexity. These changing financing practices, combined with technological, regulatory and political changes, account for the considerable challenge that the ICM lawyer faces.

ICM activity by definition shows little respect for national or jurisdictional boundaries. The complete ICM lawyer needs familiarity with comparative law and practice. It would not be surprising if many ICM practitioners felt a measure of insecurity given the pace of change; things are complex and the rules of the game are changing fast – and the transactions can be highly technical. This volume aims to assuage that concern by gathering in one place the insights of leading practitioners on relevant capital market developments in the jurisdictions in which they practise.

The book's scope on capital markets takes in debt and equity, derivatives, high-yield products, structured finance, repackaging and securitisation. There is a particular focus on international capital markets, with coverage of topics of particular relevance to those carrying out cross-border transactions and practising in global financial markets.

Of course, ICM transactions, technical though they may be, do not take place in a purely mechanical fashion – a human element is involved: someone makes the decision to structure and market the product and someone makes the decision to invest. The thought leadership and experience of individuals makes a difference; this is why we selected the leading practitioners from the jurisdictions surveyed in this volume and gave them this platform to share their insights. The collective experience and reputation of our authors is the hallmark of this work.

The International Capital Markets Review is a guide to current practice in the international capital markets in the most significant jurisdictions worldwide, and it attempts to put relevant law and practice into context. It is designed to help practitioners navigate the complexities of foreign or transnational capital markets matters. With all the pressure – both professional and social – to be up to date and knowledgeable about context and to get things right, we think that there is a space to be filled for an analytical review of the key issues faced by ICM lawyers in each of the important capital market jurisdictions, capturing recent developments but putting them in the context of the jurisdiction's legal and regulatory structure and selecting the most important matters for comment. This volume, to which leading capital markets practitioners around the world have made valuable contributions, seeks to fill that space.

We hope that lawyers in private practice, in-house counsel and academics will all find it helpful, and I would be remiss if I did not sincerely thank our talented group of authors for their dedicated efforts and excellent work in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2011

Chapter 30

UNITED KINGDOM

Will Pearce, Jonathan Cooklin, Richard Small, Dan Hirschovits and Dominic Foulkes[1]

I INTRODUCTION

i Financial Services Act 2012: moving from the FSA to the FCA and PRA

The way in which the UK financial services industry is regulated underwent a significant restructuring in 2013 with the adoption of a 'twin peaks' system of regulation and supervision.

On 1 April 2013, the Financial Services Authority (FSA) was effectively replaced by two new regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which took over the majority of the FSA's functions. Separately, the Bank of England took responsibility for financial market infrastructure (including settlement systems and central clearing counterparties such as the London Clearing House) and the Financial Policy Committee (FPC) was established. This new system of financial services regulation was made by the Financial Services Act 2012 (the FS Act). The existing FSA Handbook has been divided between the FCA and PRA depending on the section.

The FPC is responsible for macro-prudential regulation. Rather than the supervision of individual firms (micro-prudential supervision, which is the remit of the PRA and for some firms the FCA), the FPC is charged with considering the stability and resilience of the UK financial system as a whole. The governor of the Bank of England chairs the FPC and the chief executives of both the PRA and FCA are also members of the FPC. While the FPC has a number of macro-prudential tools that it can use to address potential threats to the UK's financial stability, it is the PRA and FCA that will in practice be responsible for using such tools in relation to individual authorised firms.

1 Will Pearce and Jonathan Cooklin are partners, Richard Small is regulatory counsel and Dan Hirschovits and Dominic Foulkes are associates at Davis Polk & Wardwell London LLP.

The PRA, which is an independent subsidiary of the Bank of England, is in charge of the forward-looking micro-prudential regulation of systemically important firms such as credit institutions, insurers and some investment firms. PRA regulated firms are dual-regulated firms as the FCA also regulates such firms' conduct.

The FCA is separate from the Bank of England and the PRA, having adopted the legal corporate entity of the FSA. The FCA is broadly responsible for (1) the conduct of business regulation of all firms (including dual-regulated firms); (2) the prudential regulation of firms not regulated by the PRA; and (3) market conduct. The FCA has been given certain new powers under the FS Act, including the power to make temporary (up to 12 months) product intervention rules (the FCA can both block a product launch and require that an existing product be withdrawn) and the power to require a firm to amend or withdraw financial promotions that it deems to be misleading, with immediate effect.

ii Regulation of capital markets in the United Kingdom

The FCA has continued the FSA's role in relation to the regulation of the capital markets and as such the UK Listing Authority (UKLA) has become a department within the FCA. As the UKLA, the FCA focuses on the regulation of companies that issue securities traded on financial markets. The international capital markets in the UK are regulated principally by the Financial Services and Markets Act 2000 (FSMA) and by the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules (the LPDT Rules) set out in the FCA's Handbook.

FSMA and the LPDT Rules implement into UK domestic legislation relevant aspects of the Prospectus Directive, the Market Abuse Directive, the Transparency Directive and the Markets in Financial Instruments Directive (and other EU-wide regulation related to these directives). Where permitted by EU law and regulation, FSMA and the LPDT Rules also include certain 'super equivalent' standards that go beyond the EU-wide directive minimum standards (e.g., the additional eligibility for listing requirements (LR 6), Listing Principles (LR 7), sponsor regime (LR 8) and continuing obligations (LR 9 to 12) that apply to applicants for admission to the premium (rather than standard) segment of the Official List and to premium listed companies on an ongoing basis).

II THE YEAR IN REVIEW

i Developments affecting equity offerings

The UK IPO markets in 2013

After a challenging few years for the UK initial public offering (IPO) market, a combination of macro-economic factors, including relatively low levels of volatility in the equity markets, improving equity index performance and growing confidence in the economic outlook for the UK, coupled with noticeable demand from institutional investors in the US, have given a well-needed boost to UK IPO activity. Market data indicates that the value of UK IPO activity is more than $8 billion this year. This includes, among others, the IPOs of Direct Line Insurance Group (which arguably 're-opened' the London IPO market in October 2012), Crest Nicholson, Countrywide, esure Group, Hellerman Tyton, Partnership Assurance, Foxtons and the long-awaited privatisation of the Royal Mail. Owners of companies, including private equity groups, have been attracted by favourable valuations and the potential returns from public offerings when compared with M&A, where activity, in the UK at least, has remained in the doldrums.

In addition and key to the pickup in activity, UK institutional investors, who have been some of the biggest critics of the IPO process in the UK over recent years, have seen strong equity stories in a range of issuers, potential upside in valuation post-listing and realistic pricing expectations from sellers. US institutional investors, in particular, who provide a significant degree of demand for UK IPOs, are seeking exposure to European companies once again as fear over the eurozone reduces, and they see greater opportunity in terms of company valuations when compared with the US, whose economy was quicker to recover from the global financial crisis.

It is difficult to ascertain what impact or influence, if any, on the return of IPO activity is the result of some of the limited changes to the UK IPO process, including, for example, the increasing prevalence of early-look investor meetings and pilot fishing, which were precipitated by the debate in 2011–2012 between investors and vendors over what was claimed to be the 'broken' UK IPO model.[2] However, such developments are probably here to stay. Closely linked to both the previous downturn and now the upturn in UK IPO activity are changes to the regulatory regime governing listed companies in the UK and the proposals of certain market participants for improving the efficiency of processes in the UK equity markets, discussed below.

The UK listing regime

In October 2012, the FSA published Consultation Paper CP12/25 on Enhancing the Effectiveness of the Listing Regime. With corporate governance standards at several London listed issuers firmly in the public spotlight and a general downturn in equity capital markets issuance at that time, CP12/25 identified a wide range of issues around the quality of the premium listing segment (the 'super equivalent' listing regime for companies traded on the main market of the London Stock Exchange), minority shareholder protection and free float requirements. It proposed a number of significant changes to the Listing Rules, which are the rules applying to issuers listed, or applying for listing, on the Official List.

The FCA is expected to publish a response to the consultation in November 2013 and to implement the changes proposed in CP12/25 by its predecessor, the FSA. Proposed changes of particular note include a closer focus on a new applicant for premium listing evidencing control of the majority of its business; a tightening of the more relaxed eligibility requirements for mineral and scientific research-based companies seeking a premium listing; amendments to the Listing Principles, including additional Listing Principles for premium listed companies and the introduction of Listing Principles for standard listed companies; an obligation on premium listed companies to notify the FCA of non-compliance with certain continuing obligations; and clarifications around the operation of the free float provisions and a loosening of the free float requirements in limited circumstances, including for issuers with a standard listing.

2 Open letter from Blackrock in May 2011.

In addition, perhaps the most significant of the proposed changes are expected to be for premium listed companies (or new applicants for premium listing) with a controlling shareholder (broadly, a shareholder (including persons 'acting in concert' with it) holding 30 per cent or more of the shares or voting power in a company or its parent, or with the ability to exert significant influence over the company's management through a holding of shares or voting power), including the requirement that a relationship agreement, containing provisions prescribed by the Listing Rules, be put in place between a premium listed company and its controlling shareholder; and the requirement that the board of a premium listed company with a controlling shareholder contains a majority of independent directors and for their appointment to be voted on by the independent shareholders.

The proposed new rules for companies with controlling shareholders are an attempt to ensure that a premium listed company is capable of acting independently of a controlling shareholder and its associates. Although voluntary relationship agreements between issuers and their controlling shareholders have been a feature of the UK IPO market for many years, for the first time the FCA may decide to prescribe their content.

It is proposed that a relationship agreement will need to expressly provide that (1) transactions with the controlling shareholder and its associates are conducted at arm's length and on normal commercial terms; (2) the controlling shareholder and its associates do not take any action that would prevent the company from complying with its obligations under the Listing Rules; (3) the controlling shareholder and its associates do not influence the day-to-day running of the company at an operational level or have material shareholdings in significant subsidiaries; (4) the agreement remains in effect for so long as the shares are listed on the Official List and the company has a controlling shareholder; and (5) any material changes require the approval of all independent shareholders.

As a continuing obligation, it is proposed that a premium listed company will need to comply with the relationship agreement at all times and the company's annual report must include a copy of the relationship agreement or details of where it may be obtained. In addition, the annual report will have to contain a statement by the directors that the company has complied with the relationship agreement throughout the financial year, or a description of non-compliance (including confirmation that the UK Listing Authority (UKLA) has been informed of such non-compliance).

The 'comply or explain' regime under the UK Corporate Governance Code stipulates that at least half of the directors on the board of FTSE 350 companies should be independent and that the chairman should be independent on appointment. The proposed changes to the Listing Rules would take this a step further where a company has a controlling shareholder.

Both as an eligibility requirement for new applicants for premium listing and as a continuing obligation, it is proposed that the board of directors of a company with a controlling shareholder will need to comprise a majority of independent directors, or an independent chairman and independent directors must together make up the majority of the board; there will be a six-month period to rectify non-compliance (for example, following the departure of an independent director from the board).

In addition, it is proposed that companies with a controlling shareholder will be required to implement constitutional changes that provide for a dual-voting structure for the election of independent directors, with separate approvals by the shareholders as a whole and also by the independent shareholders. If the results of these two votes conflict, a further, single, majority vote may take place not less than 90 days later.

The proposed new rules for companies with controlling shareholders would impact both applicants at the eligibility stage for premium listing and on a continuing basis once listed (including existing premium listed companies).

In a number of instances, particularly with respect to the proposed rules relating to controlling shareholders, it remains unclear how the changes to the Listing Rules and arrangements for 'grandfathering' would impact premium listed companies in practice. Suffice to say, when the final rule changes are published, issuers will need to work closely with their sponsors and other advisers to navigate their impact. As to whether the changes will strengthen the premium listing brand as intended, will remain to be seen, as will the way in which the FCA proposes to enforce them.

ABI report on encouraging equity investment

In July 2013, the Association of British Insurers (ABI), whose members, as institutional investors in the UK public markets, have more than £1.8 trillion of funds under management, published a report on encouraging equity investment, following an extensive consultation with market participants and a review of processes in the UK for IPOs and secondary capital raisings.[3] The report sets out a number of areas that the ABI believes can be addressed with the aim of improving the efficiency of the processes and attractiveness of the London market.

Areas identified for focus include the price discovery process (i.e., the process for enabling investors to understand a company's investment case and valuing its assets appropriately). The report notes that early engagement, many months ahead of an IPO, between investors and issuers is seen by all parties to the IPO process as an excellent way of addressing the information asymmetry between vendors and investors. Early engagement by vendors and companies up to a year or more before a planned IPO is encouraged by the report, and it includes a recommendation that the publication of a company's prospectus in connection with an IPO should occur earlier in the offering timetable, much closer to the time at which connected analyst research is currently published. In the ABI's view, this would enable more published independent analysis ahead of pricing of an offering, and enable investors to be better prepared for the management roadshow and be in a position to give more incisive feedback on the company and valuation. The report suggests that to help achieve such an outcome, the FCA should provide regulatory clarification that it will not regard connected analyst research (if prepared and identified properly) as part of the prospectus, and that a shorter gap between publication of such research and the prospectus will not compromise the independence of that research.

The report notes the increase in size of underwriting bank syndicates in recent years and queries whether this is additive to the IPO process, flagging that the majority of opinion is in favour of smaller syndicate sizes. Consequently, the report recommends

3 Encouraging Equity Investment: Facilitation of Efficient Equity Capital Raising in the UK Market.

that, as a rule of thumb, no more than three bookrunners should be appointed for large transactions, which the ABI suggests is above £250 million (excluding any over-allotment option). In relation to fees paid by companies to underwriting banks at IPO, the report suggests that greater transparency of the composition of the fees paid to all parties at IPO will help address the significant concern that new investors have raised about the overall level of fees on such transactions. Key recommendations include greater disclosure in the prospectus of all the fees paid for an IPO, including the maximum incentive fee. It recommends that there should be a breakdown of fees as a percentage of the size of the offering, and those fees that are independent of size, such as, but not limited to, independent advisers', lawyers' and accountants' fees, as well as syndicate members' individual fees. The other recommendation in this regard is that the final determination and payment of incentive fees should be made at the later of the release of the first quarterly results of the issuer as a listed company and three months after listing. This departs from the current practice and the preference of many banks for such incentive fees to be determined before the closing of the offering or at least no later than four to five weeks following closing.

The report provides general support for the proposed corporate governance changes to the Listing Rules for companies with controlling shareholders, recommended by the FSA in CP12/25 (discussed above), including in relation to independent boards and the requirement for a relationship agreement. The report, however, goes even further, proposing that controlling shareholders should have liability for the IPO prospectus and take responsibility in the prospectus for the future conduct of the business, including their future relationship with the company. In terms of independent board composition for companies with controlling shareholders, the ABI believes that there should be phased appointment of independent directors in the months leading up to the IPO, with an independent board in place at least one month before announcing an intention to float. One observation in the report, which received less attention, regards the role of the sponsor, the formal regulatory role under the Listing Rules, typically fulfilled by one of the lead syndicate members. The report states that there is a concern that this role is limited in its effectiveness, primarily because where the sponsor is also one of the lead underwriters or distributors of an IPO, as is usually the case, it may be conflicted if there are contentious issues with the company. It goes on to note that this has raised the possibility of other professional firms such as lawyers and accountants taking on this regulatory role. To date, the FCA has made no formal pronouncements on this topic, but it would not be a surprise, given the increasing scrutiny by the FCA of the sponsor role, were this to be the subject of focus by them over the coming months.

UKLA new and amended technical and procedural notes

At the end of 2012, the UKLA launched the UKLA Knowledge Base, a new online repository for UKLA guidance on the LPDT Rules. The revised and new guidance notes primarily reflected material from previous UKLA notes, updated for legal, regulatory and market developments and reformatted into short notes on individual topics within the LPDT Rules. Unlike previous UKLA guidance notes, and with effect from the legal switchover from the FSA to the FCA (described above), the new and revised notes constitute formal FCA guidance. The UKLA intends to maintain the notes and produce additional guidance in the future. With a vastly expanded number of guidance notes having been published by the UKLA, together with others that are under current consultation, it is not the aim of this article to provide detailed commentary on the guidance available. However, in the context of the recent regulatory focus on enforcement action against listed companies for non-compliance with the Listing Rules, the regulatory attention placed on the role of sponsor and an upturn in UK IPO activity, one new UKLA technical note and one amended UKLA procedural note are worth highlighting.

Following the £14 million fine and public censure of Prudential in March 2013 for failing to deal with the FSA in an open and cooperative manner in breach of Listing Principle 6 (which applies to all companies with a premium listing) in relation to its aborted acquisition of AIA in 2010, the UKLA has proposed guidance on 'dealing with the FCA in an open and co-operative manner' in a new technical note.[4] The warning notice in connection with the enforcement action against Prudential highlighted that Listing Principle 6 requires issuers to contact the FCA at an early stage when they are contemplating a significant transaction. The FCA noted that following the enforcement action against Prudential it felt it appropriate to provide some additional guidance to outline some factors that should be taken into account when trying to ascertain whether a transaction is significant and whether early contact with the FCA is necessary. Examples in the proposed guidance of types of transactions where the UKLA would expect a company to carefully consider the timing of initial contact with the FCA, to give the FCA sufficient time to consider the substantive matter presented and to form a view, include reverse takeovers and Class 1 disposals by issuers in severe financial distress. A routine Class 1 transaction with a limited role for the FCA before submission of the circular is unlikely to require early contact. Importantly, where a company is unclear whether Listing Principle 6 applies, it should consult the FCA at the earliest possible stage if there is any doubt about how a Listing Rule applies in a particular situation.

In terms of the UKLA's procedure for reviewing eligibility for listing for a company's securities, the process has changed recently, as reflected in an amended procedural note on the 'eligibility review process'.[5] While historically, the UKLA reviewed the eligibility letter (setting out how an applicant meets the relevant conditions for listing) ahead of reviewing the prospectus, earlier this year the UKLA changed the process such that the eligibility review will happen at the same time as the review of the prospectus. According to the UKLA, some advisers had questioned the former sequential review process (eligibility letter followed by prospectus) on the basis that without a prospectus to review, the eligibility review phase often got repeated during the prospectus review process, sometimes by different staff, thereby lengthening the overall process. The change in approach is intended to improve the overall admission process. However, to address the concern that this approach would require significant front-loading of a transaction at the eligibility stage (for example, by having to draft a prospectus at the outset), the UKLA has clarified in the procedural note that the opportunity to discuss eligibility before submitting a prospectus is available. The UKLA states that it is happy to confirm

4 Primary Market Bulletin: Edition No. 6 and UKLA/TN/209.1. Also see Primary Market Bulletin: Edition No. 7 and UKLA/TN/713.1.

5 UKLA/PN/901.2.

that, if an applicant wishes to interact with it in that way, it will be willing to allocate staff to discuss the case and will not seek to limit the applicants who use this arrangement.

Guidance on financial position and prospects procedures

In February 2013, the Institute of Chartered Accountants of England and Wales (ICAEW) published helpful new guidance on financial position and prospects procedures, which the Listing Rules require directors of a company seeking a premium listing to have established.[6] Among other things, the guidance explains how directors of companies can demonstrate that they have established financial position and prospects procedures, how directors should determine whether they have established appropriate procedures (including illustrative evaluation criteria), and how directors may obtain sufficient evidence that they have established the procedures. For reporting accountants providing a report on aspects of a company's financial position and prospects procedures or an assurance report as to whether the directors have established the necessary financial position and prospects procedures, guidance is included on the terms of the engagement (including example paragraphs for an engagement letter) and what to include in an assurance report (including typical elements and example paragraphs). It also covers the role of sponsors and other corporate advisers, and how they should approach their regulatory obligations in relation to financial position and prospects procedures. In this latter regard, it provides a helpful reference source for sponsors in addition to the UKLA technical note on the topic (see above).[7]

ii Developments affecting debt offerings

The UK debt markets in 2013

Yields on government and investment grade corporate bonds remain at near record lows, reflecting a continued low interest rate environment, and the ongoing impact of central bank quantitative easing measures and the US Federal Reserve's stimulus programme. In many respects, the position for debt markets in the UK today does not look significantly different from last year, although there is increasing press commentary about the risk of a bubble in the bond markets, and the potential for a market correction. Partly as a result of investors seeking riskier assets and improving sentiment in the equity markets, 2013 has seen a marked increase in convertible bond issuance, particularly in the real estate sector, where issuers have sought to diversify their funding methods and many are looking to refinance existing bank credit facilities. In addition, high-yield bonds, which are less sensitive to movements in interest rates and the gilt market, have been popular with investors.

Retail bonds

Retail bonds in the UK have grown in popularity over the last couple of years and since its launch in 2010, the London Stock Exchange's Order Book for Retail Bonds (ORB) has hosted approximately 40 corporate bond issues and raised approximately £3.4 billion

6 TECH 01/13 CFF Guidance on financial position and prospects procedures.

7 UKLA/TN/708.1.

from small investors looking for yield. Unlike many countries in Europe that have long had successful retail bond markets, UK companies' previous unwillingness to issue notes in denominations of less than £50,000 has acted as a block on the development of a similar market in London. However, since the launch of the ORB, listed retail bonds have been issued by companies such as National Grid, Severn Trent, Tesco Personal Finance and even the LSE. Listed retail bonds are effectively retail-size corporate bonds. They are listed and can be bought and sold on the secondary market via trading on the ORB. By virtue of their small denominations (for example, £1,000), retail bonds are targeted at individual rather than institutional investors. Securities admitted to trading on the ORB are admitted to LSE's EU-regulated main market, and listing involves the two-stage process required for admitting any security to trading on the LSE's main market: namely, admission to the Official List of the UKLA, followed by admission to trading on the main market of the LSE. In addition, to list retail bonds, they must comply with minimum disclosure requirements for the retail regime under the Prospectus Directive, which will require a prospectus to be approved before the bonds are offered or listed; be tradeable in units of no larger than £10,000; be set up for settlement in CREST; and be supported by a committed market maker willing to provide electronic two-way prices throughout the trading day.

In line with the FCA's focus on retail investors, as illustrated by its proposed guidance on prospectus disclosure requirements for investors in non-equity securities,[8] it remains to be seen how practice around prospectus format and disclosure develops in this area. Some market observers have raised concerns that it may be possible for companies to benefit from the relative lack of sophistication of investors in retail bonds by using less creditworthy group companies to issue debt, including fewer noteholder protections in their bond terms (when compared with that in the institutional market) and also offering comparatively lower yields.

Consent solicitations and fees

Consent solicitations are often used by issuers in debt restructurings to solicit consent from their noteholders to amend the terms of the issuer's securities. Frequently, the issuer offers a payment to noteholders who vote in favour of the consent solicitation. In April 2013, the Court of Appeal in *Azevedo & Anor v. Imcopa, Exportacao E Industria De Oleos Ltd & Ors*[9] upheld a decision of the High Court on the legality of consent payments to holders of debt securities. Both courts agreed that payments offered in exchange for noteholder votes to amend the terms and conditions of the securities are legal and valid if the payments are openly disclosed to all noteholders before the relevant vote takes place; the payments are payable on an equal basis to all noteholders voting in favour of the proposed amendments; and all noteholders are free to vote. The decision confirms market understanding in relation to consent payments, namely that provided the offer of the payment is made openly and not privately, and to all noteholders on the same terms, such payments are permissible. In relation to an argument put forward by the claimants

8 Primary Market Bulletin: Edition No. 7 and UKLA/TN/632.1

9 [2013] EWCA Civ 364.

that the different treatment of consenting and non-consenting noteholders violated the requirement that the noteholders as a class should be treated *pari passu* in all respects, the Court of Appeal upheld the High Court's decision, finding that under the trust deed governing the note issue, the *pari passu* obligation only applied to money in the hands of the trustee and, on the facts, the funds did not pass into or through the hands of the trustee; the payments being made by the issuer directly into accounts in Euroclear or Clearstream, in return for acceptance of the offer. In terms of practical guidance on this latter point, issuers should make sure they avoid consent payments being made by a trustee (or other party) who is obliged to make payments on a *pari passu* basis, if they wish to ensure that payments are valid.

Prospectus disclosure requirements for convertible and exchangeable securities

In August 2013, Commission delegated Regulation (EU) No. 759/2013 amending the Prospectus Regulation (Regulation (EC) No. 809/2004) as regards the disclosure requirements for convertible and exchangeable debt securities came into force. The delegated regulation incorporates proposals suggested by the European Securities Markets Authority (ESMA). Among other things, where debt securities are convertible or exchangeable into shares that are or will be issued by the issuer of the debt security or by an entity in its group and those underlying shares are not admitted to trading on a regulated market, a prospectus must contain a working capital statement and a statement of capitalisation and indebtedness in respect of the issuer of the underlying share.

Regulatory capital

This year has seen a number of developments in tax law and practice of relevance to the debt capital markets. HMRC, the UK tax authority, has continued work on regulatory capital securities. Draft regulations[10] have been published for consultation that aim to give certainty to issuers and holders alike as to the tax treatment of Additional Tier 1 and Tier 2 securities issued by certain financial institutions. The draft regulations – which, if implemented, would apply to regulatory capital securities currently in issue, as well as to newly issued instruments – address a number of problem areas advisers commonly contend with, and are to be welcomed. For instance, they clarify that the securities are exempt from UK withholding tax and UK stamp duty, and deal with certain technical points in the corporation tax grouping rules. Most significantly, the draft regulations would ensure that interest on Additional Tier 1 securities is deductible for issuers – as well as interest on Tier 2, which is already expressly deductible following legislation introduced earlier this year. Distributions on Common Equity Tier 1 will remain non-deductible.

That said, the proposals do not quite dispense with all complexity in this area. For a start, they are aimed squarely at bank issuers. Issuers of other regulatory or highly subordinated securities – instruments issued by insurance companies under Solvency II, for example, or corporate hybrid debt – will continue to grapple with the income distribution code to determine whether finance costs are deductible. Another important feature of the draft regulations is the proposal that the issuer does not need to bring in

10 The Taxation of Regulatory Capital Securities Regulations 2013 (draft).

a tax charge if the debt gets written down or converted to equity in accordance with its terms. This seems to have the knock-on effect that a UK corporate holder would not be able to recognise a loss for tax purposes.

FATCA

In the UK as elsewhere, much draftsman's ink has been spilt advancing the cause of the US Foreign Account Tax Compliance Act (FATCA). The approach in bond documentation now looks to be reasonably well settled, with noteholders accepting FATCA as their risk, and disclosure being set out in the US Tax Section, the risk factors, or both. As a drafting matter, one increasingly common practice in English law deals issued into clearing systems is to include provision permitting payments to be made under deduction of FATCA withholding in the payments clause, rather than by way of carve-out from the gross-up (which will generally operate by reference to withholding taxes imposed by the issuer's own tax jurisdiction); some firms, however, think that including an express carve-out for FATCA remains the more advisable approach. For UK financial institutions, 2013 has brought greater certainty, with amendments being made to the UK–US inter-governmental agreement (IGA) to extend the scope of institutions and products outside the scope of FATCA, and the publication of detailed domestic regulations and guidance. FATCA compliance in the UK will thus be increasingly assimilated into the wide suite of domestic data-gathering provisions that already apply to UK financial institutions.

Financial Transactions Tax

The EU Commission's proposed Financial Transactions Tax (FTT) has also attracted much comment this year. In default of unanimity among Member States, the FTT has been developed by a coalition of the willing – excluding the UK – under the EU's 'enhanced cooperation procedure'. The proposed FTT would generally apply to transactions in securities (other than their issuance) where at least one of the parties is a financial institution established in one of the participating Member States. A controversial feature of the proposals is that a financial institution could be deemed established for these purposes – and thus liable for the tax – simply by transacting with a counterparty that is itself established in a participating jurisdiction. The FTT would also apply where parties are dealing in securities issued by a FTT zone issuer, regardless of where those parties are themselves established.

The UK government has been an opponent of the proposals since they were first aired in 2011, and indeed has launched proceedings against the Council of the European Union challenging the legality of the tax. Embarrassingly for proponents of the tax, a non-binding legal opinion prepared by the Council's own legal service has recently been leaked to the press, which robustly concludes that the proposed tax would be unlawful. What this spells for the future of the project (which still has its strong supporters) remains to be seen. However, if it is to be introduced at all, it is possible that some redesigning of the proposals will be necessary; and the date initially advertised for commencement of the tax – 1 January 2014 – is almost certainly unrealistic. Tax disclosure about the possible introduction of the FTT has become a familiar sight in offer documentation on debt deals.

iii Developments affecting derivatives, securitisations and other structured products

While on one hand many have feared that the international push to regulate derivatives, securitisations and other financial instruments could lead to the smothering of certain sectors, legislators and regulators have, on the other hand, recently acknowledged the importance of these products. For example, in a policy paper dated 25 March 2013,[11] the European Commission noted that '[r]eshaping securitisation markets could […] help unlock additional sources of long term finance'. In late September, Stefan Ingues, the head of the Basel Committee on Banking Supervision (BCBS), noted that '[s]ecuritisations need not in any sense be bad', adding that the current risk weightings would be reviewed in 2014.[12]

EMIR developments

The quest to bring OTC derivatives within the regulated space continued apace in 2013. Despite coming into force on 16 August 2012, the main requirements under the European Market Infrastructure Regulation (EMIR)[13] have not yet come into effect. The clearing obligation is currently expected to be phased in from mid-2014 and the reporting obligation would be likely to commence in early 2014. In February 2013, a number of delegated regulations were published in the Official Journal supplementing various aspects of EMIR.

ESMA is consulting on draft Regulatory Technical Standards (RTS) in connection with the application of the risk mitigation requirements under Article 11 of EMIR to derivative contracts between third country entities that have a 'direct, substantial and foreseeable effect in the EU'. ESMA is charged with producing a draft by 15 November 2013. Further RTS are expected in relation to the clearing requirement and the capital requirements and exchange of collateral aspects of the Article 11 risk mitigation techniques.

Capital Requirements Directive and Regulation adopted

The fourth Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) were published in the Official Journal of the European Union on 27 June 2013. CRD IV came into force on 28 June 2013 with EU Member States having until 31 December 2013 to transpose the directive into national law. The CRR came into force on 17 July 2013 and will apply from 1 January 2014 (and as such is binding on Member States from that date without the need for national transposition). A number of the reforms introduced by the adoption of CRD IV and CRR will impact the credit markets and securitisations; these include the new risk retention requirements, the liquidity coverage and net stable funding requirements and the leverage ratio.

11 European Commission Green Paper: Long-Term Financing of the European Economy, 25 March 2015 COM(2013) 150 final.

12 *The Financial Times*, 29 September 2013.

13 Regulation (EU) No. 648/2012 of 4 July 2012 on OTC derivatives, central counterparties (CCPs) and trade repositories (TRs).

A number of national regulators have already adopted liquidity coverage ratio and the net stable funding requirements.

Securitisation in the Basel framework

The BCBS published a consultation document in December 2012 setting out its proposed revisions to the Basel securitisation framework. The aim of the proposals is to make capital requirements more prudent and risk-sensitive. The consultation deadline for comments was 15 March 2013, although in a speech given in March 2013, the BCBS Chairman noted that they intended to complete their policy work on securitisation in 2014.

Repeal of UK withholding tax on manufactured overseas dividends (MODs)

A tax development that may give some advisers cause to breathe a sigh of relief is the repeal (with effect from 1 January 2014) of the UK withholding rules on manufactured overseas dividends. MODs are, broadly, payments representative of dividends or interest on non-UK securities – and commonly arise under repos, stock loans, equity derivatives or other collateralised trades. The current rules are notoriously complex and result in UK payers of MODs having to operate withholding in certain circumstances (and for certain UK recipients of MODs to account for a 'reverse charge') – which in turn raises complex questions of risk allocation under the market standard documentation. The changes bring welcome simplification to a difficult area.

iv Relevant tax law

Aside from the developments touched on above, 2013 has been a busy year for international capital markets (ICM) tax advisers. The focus in politics and the media on avoidance activity has lost none of its ardour, and probably the biggest single domestic development in that arena is the coming into force of the UK's General Anti-Abuse Rule (GAAR). Much of the published guidance on the GAAR concentrates (as was to be expected) on avoidance schemes, and the direct impact of the GAAR on ICM commercial transactions may not be hugely significant. It was, however, helpful to see HMRC guidance to the effect that structuring securities as quoted Eurobonds (so that interest will be exempt from UK withholding tax) would not generally be seen as abusive, even where the securities are not widely traded; and there is some reasonably comforting guidance around the familiar 'B share scheme' planning for returning capital to holders of public companies. Another key highlight is the unveiling by the OECD of its much anticipated action plan on 'Base Erosion and Profit Shifting', which sets an ambitious agenda and timetable on strengthening the international tax system against instances of double non-taxation: structured securities that look to achieve a tax deduction in the issuer's country with no taxable pickup for the holder are a particular target. And UK-based multinationals are getting to grips with the UK's (overall helpful) new controlled foreign companies rules, which came into effect this year.

More directly in the debt capital markets sphere, a disguised interest rule has been introduced in this year's UK Finance Act, which levies income tax on certain interest-like returns, and may pave the way for further reform of the taxation of investment income – in particular the current rules on discount bonds and accrued interest. A wide-ranging consultation on the UK's loan relationships and derivative contracts code has also been launched, with targeted anti-avoidance provisions promised for 2014 (to rectify perceived deficiencies with the current 'unallowable purpose' tests and other provisions), and broader structural reforms to follow in 2015.

On the equity side, advisers now have greater certainty on the stamp duty and Stamp Duty Reserve Tax implications of share issuances into clearance and depositary receipt systems, following the decision of the First-tier Tribunal (Tax) in *HSBC Holdings Plc and The Bank of New York Mellon Corporation v. The Commissioners for HMRC*[14] last year and the subsequent HMRC guidance. While the provisions imposing the 1.5 per cent charge remain on the statute book, market participants are now generally comfortable that HMRC will no longer seek to collect the charge – which was found to be contrary to EU law – on capital raisings issued into these systems (whether EU or non-EU systems). Whether this development leads to a shift in traditional UK market practice on underwriting agreements (whereby banks undertake to 'procure subscribers' for shares, rather than subscribe themselves as principal and on-sell – a mechanism that minimises UK stamp taxes) is perhaps a point to watch out for, particularly in light of US securities law requirements on Rule 144A issuances.

v Role of exchanges, central counterparties (CCPs) and rating agencies

Proposed Regulation on benchmarks

The European Commission published a proposed Regulation on indices used as benchmarks in financial instruments and financial contracts (the Benchmarks Regulation) on 18 September 2013. The proposed Benchmarks Regulation aims to ensure the integrity of benchmarks and restore confidence in them by ensuring that benchmarks (1) are not subject to conflicts of interest; (2) are used appropriately; and (3) represent the market or economic reality that they are intended to measure.

The proposed Benchmarks Regulation applies to any benchmark used to determine an amount payable under or value of a financial instrument or a financial contract or that is used to determine the performance of an investment fund. Broadly, the Benchmarks Regulation aims to improve the governance and controls over the benchmark process, improve the quality of input data, ensure that data contributors provide adequate data and are subject to adequate controls, and ensure the supervision and viability of critical benchmarks. It also aims to protect consumers and investors by enhancing the transparency of the data and methodology used to calculate the benchmark. The proposed Benchmarks Regulation will now enter the usual European legislative process and will then be directly applicable throughout the EU one year later (it is unclear exactly when this would be, but it is not likely to come into force before the end of 2014 at the earliest).

14 [2012] UKFTT 163 (TC).

Credit Ratings Agencies Regulation III

The third Credit Rating Agencies Regulation (CRA III)[15] was adopted on 21 May 2013. CRA III has a particular impact on those involved in the issuing of structured finance instruments. In particular, it requires issuers, originators and sponsors of structured finance instruments established in the EU to make a number of ongoing disclosures in relation to 'the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures'.

ESMA has until 21 June 2014 to publish regulatory technical standards – as a result market participants will have to wait until then to find out exactly what needs to be disclosed, and when and how such disclosures need to be made. The proposal to require a mandatory rotation of credit rating agencies was adopted in respect of new re-securitisations with underlying assets from the same originator. Further, the European Commission must report to the European Parliament and Council by 1 July 2016 on whether the rotation mechanism should be extended to other asset classes.

vi Regulation of fund managers

While the Alternative Investment Fund Managers Directive (AIFMD),[16] which entered into force on 21 July 2011 with Member States having until 22 July 2013 to implement it, is primarily aimed at regulating the buy-side investment management space, it has significant consequences for the international capital markets. The AIFMD broadly aims to create a single harmonised pan-European regulatory framework for EU-established managers (Managers) of alternative investment funds (AIFs) and for the marketing in the EU of both EU and non-EU AIFs by non-EU Managers. The AIFMD does not directly apply to the AIFs themselves, although it is worth bearing in mind that the AIF would remain subject to applicable Member State law and regulation, if any.

Two aspects of the AIFMD will have a particular impact on participants in the international capital markets: the first is the restrictions placed on Managers in relation to asset stripping and the second is the restrictions placed on non-EU Managers on the marketing of funds in Member States – this will place a considerable burden in the IPO of vehicles that are deemed to be AIF under the AIFMD.

Asset-stripping

Managers (including non-EU Managers) now face restrictions on asset-stripping during the first 24 months following acquisition (by an AIF marketed to EU investors) of control of a non-listed company established in the EU. Broadly, Managers will be prohibited from facilitating, supporting or instructing any distributions, capital reductions, share redemptions or acquisitions by the non-listed company of its own shares. Managers

15 Regulation (EU) No. 462/2013 of 21 May 2013 amending Regulation (EC) No. 1060/2009 on credit rating agencies.

16 Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers.

will also not be allowed, to the extent that they can vote on behalf of the non-EU AIF they manage, to vote in favour of such action and should use their best efforts to prevent such action.

IPOs

Where an entity that is the subject of an IPO is deemed to be a AIF under the AIFMD, the subject of the IPO will only be able to be marketed in Member States in accordance with the AIFMD. Broadly, this means that from 22 July 2013 onwards, non-EU Managers marketing non-EU AIFs to EU investors may continue to make use of Member States' existing private placement regimes provided that (1) they comply with certain disclosure and transparency requirements; (2) appropriate information sharing agreements are in place between the relevant Member State and the jurisdictions of establishment of both the non-EU AIF and the non-EU Manager; and (3) the jurisdictions of establishment of both the non-EU AIF and the non-EU Manager are not on the Financial Action Task Force's Non-Cooperative Country and Territory list. A number of Member States have, however, adopted a one-year transition period, under which a Manager, which has been marketing an AIF in the Member State before 22 July 2013, may continue to do so under the pre-AIFMD private placement regime until 21 July 2014. Several Member States have adopted implementing regulations that require a non-EU Manager to obtain prior approval before marketing can be undertaken in their jurisdiction – this prior approval can take up to four months to obtain. Consequently, where an IPO of a fund-like entity is being contemplated, an analysis as to whether the structure would be likely to be characterised as an AIF under the AIFMD should be carried out at the early stages of the process and, depending on the outcome of that analysis, consideration should be given as to the Member States in which the securities are to be offered and the requirements for marketing in those Member States should be considered.

Looking forward, from the second half of 2015, non-EU Managers may, subject to advice from ESMA on the extension of the regime to non-EU Managers, use the pan-EU passport regime to market their AIFs provided that the relevant non-EU Manager first becomes authorised in a Member State and complies with the various regulatory requirements that authorisation implies, including, in relation to disclosure and transparency, limits on leverage, the appointment of a depositary and remuneration. From the end of 2018, and subject to ESMA's advice, the existing Member States' private placement regimes may be withdrawn.

III OUTLOOK AND CONCLUSIONS

i Remuneration at banks and other financial institutions (CRD IV)

The 'solution' to the question of bankers' bonuses made it onto the statute books with the publication of CRD IV (see above). CRD IV includes restrictions on bonus payments by credit institutions and investment firms. The remuneration requirements set out in CRD IV apply to all credit institutions (including banks) and investment firms in the EU and the non-EU subsidiaries of such entities as well as EU subsidiaries of financial institutions headquartered outside the EU.

Specifically, the requirements apply to employees whose professional activities have a material impact on the risk profile of the relevant financial institution, including senior management, risk takers, employees engaged in control functions and employees whose total pay puts them into the same bracket as senior risk management and risk takers. The 'variable pay' of such employees is capped at 100 per cent of total fixed pay or, with shareholder approval, 200 per cent of total fixed pay. Variable pay includes payments or benefits that depend on performance and, in exceptional circumstances, other contractual elements that do not 'form part of a routine employment package' (examples of routine elements of compensation include health care, childcare facilities or proportionate regular pension contributions). Member States have the discretion to adopt stricter standards (e.g., lower bonus caps). At least 50 per cent of any variable pay must consist of shares or equivalent ownership interests (or share-linked or equivalent non-cash instruments, for non-listed institutions) with at least 40 per cent of any variable pay being deferred over a period of at least three to five years. Up to 100 per cent of variable pay must be subject to clawback or *malus* arrangements. Financial institutions will be required to set specific criteria for such arrangements.

As stated above, Member States have until 31 December 2013 to implement CRD IV into local law that should be applicable from 31 December 2013. The ratio of variable to fixed pay will apply to 'services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before or after 1 January 2014'. In September 2013, the UK commenced legal proceedings at the European Court of Justice in Strasbourg challenging the bonus cap.

ii The new Market Abuse Regulation

On 10 September 2013, the European Parliament formally endorsed the political agreement reached on the new Market Abuse Regulation (MAR). In broad terms, the draft MAR aims to update and strengthen the existing Market Abuse Directive[17] to keep pace with market developments. The market abuse regulatory framework is being extended to commodity and related derivative markets; the manipulation of benchmarks is being explicitly banned; and the scope is being extended to financial instruments traded only on multilateral trading facilities and other organised trading facilities (a new category of trading facility being introduced by the proposed revision to the Markets in Financial Instruments Directive).

MAR also introduces harmonised rules for administrative measures, sanctions and fines, with Member States being free to set higher fines and to use additional sanctioning powers. In addition, the proposal for a new directive on criminal sanctions for insider dealing and market manipulation (referred to as CSMAD) will introduce harmonised rules on criminal offences and sanctions for market abuse. However, the UK government has announced its decision not to opt in to CSMAD at the present time (it being noted that UK criminal law already covers market abuse offences).

17 Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse).

Some aspects of the proposed MAR will be of particular interest to those involved in IPOs, rights issues and public takeovers:

a following on from the *Spector Photo Group* case,[18] the recitals to MAR now provide for a rebuttable presumption that where it is established that a person has dealt while in possession of inside information, that information was 'used' in carrying out the transaction;

b the cancelling or amending of an order concerning a financial instrument to which inside information relates where the order was placed before the person concerned possessed the inside information will now be considered insider dealing;

c in relation to improper disclosure, there are new provisions on 'market soundings' applicable to issuers, secondary offerors and their agents. This has been a hot topic recently and the new provisions are potentially significant to the extent that they (1) provide a firm framework that market participants can rely on (there seems to be some uncertainty as to the exact scope of present UK rules) and (2) can be relied on throughout the whole of the EU; and

d in the context of takeovers, new provisions provide that possessing inside information obtained in the conduct of a public takeover or merger and using that information for purposes of that takeover bid or merger will not, in itself, be deemed to constitute insider dealing. However, for this 'safe harbour' to apply, the inside information must have been made public (or otherwise ceased to be inside information) when the merger was approved or the shareholders accepted the offer. Stakebuilding using inside information is expressly excluded from the scope of these provisions.

The final adoption of MAR must await political agreement on the proposed revised Markets in Financial Instruments Directive as certain aspects will need to be aligned (in particular with respect to the scope of MAR). In practice, this means that the earliest likely implementation date of MAR will be mid-2014 to January 2015.

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18 Judgment of 23 December 2009 of the European Court of Justice in Case C-45/08.

Appendix 1

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Dominic Foulkes is an associate in Davis Polk's tax department, practising in the London office. He advises on the UK tax aspects of matters from across the firm's practice, and has experience of advising issuers and underwriters in debt and equity capital markets transactions.

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