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# TREASURY ESSENTIALS

Need to know for treasurers and their teams

## JUNE 2024 / INTRODUCTION

Welcome to this edition of Treasury Essentials, our bi-annual publication which seeks to provide insight into topical legal issues of relevance to finance and treasury teams.

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With the UK election around the corner (and elections in a number of other countries to follow), attention is currently focussed on the polls. Outcomes in terms of treasury priorities – economic growth, support for investment, improved access to capital, fiscal and regulatory certainty, a clear, workable (and fundable) pathway to net zero to name a few – remain uncertain at the time of writing.

The impact on existing policy proposals also remains to be seen. For now, we have summarised the existing proposals for reforms to both the UK and EU prospectus regimes. With growing interest in the role of technology in financial markets, we also discuss ISDA's proposed new online platform – the ISDA Notices Hub – designed to improve the speed and efficiency of delivering and receiving notices under ISDA Master Agreements. On the loans side, we consider the LMA's new drafting for extension options and its updated guidance on the implications of DAC6 and the UK equivalent tax reporting regime for facility agreements.

I hope you enjoy this edition of Treasury Essentials. If you would like to explore any of the topics covered in more detail, or if you have any thoughts/feedback on this or previous editions of Treasury Essentials, please get in touch with your usual Slaughter and May contact or a member of the Treasury Essentials team. If any of your colleagues or contacts would like to receive this publication, please click here.

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# PROGRESS ON PROSPECTUS REFORMS: UK AND EU

The UK and EU prospectus regimes are to be reformed in the coming years, impacting issuers of securities listed on UK and EU regulated markets. On the whole, the changes to the EU Prospectus Regulation represent targeted refinements rather than substantive changes, with some useful new flexibility afforded to debt issuers. In contrast, the proposed changes to the UK prospectus regime represent a fundamental overhaul of the existing regime, with the UK Prospectus Regulation being repealed and replaced. Below we look at the progress of these reforms, focusing on key highlights for issuers of debt securities.

## EU Listing Act finalised: Changes to the EU Prospectus Regime

In April 2024, the European Parliament approved a package of proposals (known as the "**EU Listing Act**") designed to simplify EU listing rules to make capital markets in the EU more attractive for companies and facilitate access to capital, particularly for SMEs. The EU Listing Act includes a proposed Regulation to amend the EU Prospectus Regulation as well as other legislation and is expected to come into force in the last quarter of 2024. Reforms to the EU Prospectus Regulation are due to be implemented on a staggered basis, with some changes applying as soon as the Act is in force and others applying up to 18 months later.

Key highlights include:

- **Incorporation of future financials**: issuers seeking admission to trading on an EU regulated market will not be required to publish a supplement to a base prospectus in order to update for annual or interim financial information if it is within the 12-month period for which a base prospectus is valid (although issuers may continue to publish supplements voluntarily for this purpose if they wish to do so).
- **ESG disclosure requirements in prospectuses**: the European Commission will be empowered to adopt delegated acts which take into account ESG factors or pursuing ESG objectives. For bonds issued under the EU Green Bond Standard ("**EU GBS**"), prospectuses will need to incorporate by reference the relevant information in the green bond factsheet, and for bonds issued under the "optional disclosure regime" set out in the EU GBS, prospectuses must include the relevant information required under the regime and set out in the EU GBS (further details on the EU GBS can be found in our briefing).
- **Standardising prospectuses**: the format and sequence of information in a prospectus is to be standardised, with the European Commission being empowered to adopt delegated acts setting out further detail. This will include a greater emphasis on increasing comprehensibility by using plain language, and making the information concise, clear and user friendly.
- **Supplements cannot be used to introduce a new type of security**: supplements will not be permitted to introduce a "new type of security" for which the relevant information has not been included in the base prospectus unless necessary to do so to comply with capital requirements.
- **Expansion of existing prospectus exemptions**: several exemptions from the requirement to publish a prospectus have been expanded. For instance, the existing "fungible securities exemption" (from the obligation to publish a prospectus where fungible securities are admitted to trading and they represent, over a period of 12 months, less than 20 per cent. of the securities already admitted to trading) has been expanded with the threshold increased to 30 per cent. and offers of securities to the public also included, provided certain conditions are met.

This briefing discusses the impact of the reforms for the debt capital markets in full with a separate briefing covering the impact for the equity capital markets.

**The UK and EU prospectus regimes are to be reformed in the coming years, impacting issuers of securities listed on UK and EU regulated markets.**

## Overhaul of the UK Prospectus Regime

The UK prospectus regime is expected to be overhauled in the next year or two following the recommendations of the Hill Review, with the aim of making regulation in this area more agile and effective and delegating a greater degree of responsibility for the regime to the UK Financial Conduct Authority (the "**FCA**"). A key milestone was reached in January 2024 with the finalisation of the Public Offers and Admissions to Trading Regulations (the "**Regulations**") which lay the foundations for the new regime, creating a new framework for the offering of securities to the public and the admission of securities to trading in the UK. Some key highlights for capital markets practitioners are set out below (please see our briefing for further detail):

- **Designated activities regime**: the Financial Services and Markets Act 2023 introduces the new "Designated Activities Regime". The Regulations exercise powers under the Designated Activities Regime to create new designated activities of: (i) offering relevant securities to the public in the UK, (ii) admitting or requesting admission of transferable securities to a UK regulated market or a primary MFT, and (iii) advertisements/related communications in relation to offers/admissions. The FCA has been given new powers to make rules in relation to each designated activity.
- **A new public offers architecture**: under the current regime, it is unlawful to make an offer to the public in the UK without publishing a prospectus unless an exemption applies. Under the new regime, the Regulations will make it unlawful for a person to offer relevant securities to the public in the UK unless an exemption applies. "Relevant securities" include non-transferable securities such as minibonds, delivering on the recommendation of the Gloster Review. Most of the exemptions to the public offer prohibition under the current UK prospectus regime will be retained, including for debt capital markets, the "qualified investor" and "wholesale debt" exemptions (although it should be noted that the wholesale debt exemption threshold will change from €100,000 to £50,000 to allow for wholesale securities under the EU Prospectus Regulation to be offered into the UK on a cross border, exempt public offer basis).
- **Admission to trading on a UK regulated market**: under the new regime, the FCA will be given enhanced rulemaking responsibilities regarding admissions of securities to trading on UK regulated markets. This will allow the FCA to specify when a prospectus is required and what it should contain, and to address the manner and timing of validation and publication. FCA rulemaking responsibilities will also cover other matters that currently sit in the UK Prospectus Regulation.
- **Primary MTFs**: the FCA also has rule-making powers in relation to securities admitted to trading on a primary MTF. These powers will broadly allow the FCA to require an "MTF admission prospectus" to be published where transferable securities are admitted to trading on a primary MTF that is open to retail investors.
- **The necessary information test**: the Regulations make some alterations to the "necessary information" test for determining what information should be included in a prospectus, including a helpful clarification that for debt securities, the reference to "prospects" (i.e. "*the necessary information which is material to an investor for making an informed assessment of the assets and liabilities, profits and losses, financial position and* ***prospects*** *of the issuer and of any guarantor…*" ) should be read as a reference to the creditworthiness of the issuer and any guarantor.
- **Protected forward-looking statements**: the Regulations establish a different liability threshold (based on fraud or recklessness) for certain categories of forward-looking statements in prospectuses, which follows a recommendation in the Hill Review to remove deterrents in the existing regime which has a negligence-based threshold. The FCA is responsible for specifying the categories of forward-looking information that will be in scope.

Most of the substantive provisions in the Regulations will not come into effect until the FCA has formally consulted and published its detailed rules. The detail of these rules will be particularly important for debt capital markets as a number of changes to the regime are likely to be set out therein. The FCA has already sought early engagement from market participants in 2023 (see our briefing for further detail) and is expected to formally consult on its new rules in the coming months. It is therefore likely that the new UK prospectus regime will not be in place until 2025 at the earliest.

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# ISDA'S NOTICES HUB: A SOLUTION FOR DELIVERY OF CRITICAL NOTICES – A BUY-SIDE PERSPECTIVE

Many market participants will have received the recent letter from ISDA asking for industry support for the ISDA Notices Hub – a project which aims to go a step further than re-thinking the delivery of notice provisions in the ISDA Master Agreement and, more fundamentally, modernise the manner in which market participants can validly serve notices, receive notices and keep their own notice details accurate facing their counterparties. The success of the Notices Hub will rely on wide adoption within the industry.

## Experiences with Notices

Market participants have, at times, experienced difficulties not only with actual delivery of notices, but also with the circumstances and ways in which the delivery is deemed effective under the ISDA Master Agreement. These problems have been particularly acute during periods of market stress such as a financial crisis and exasperated during more general disruptions such as a pandemic or war. In such times, the provisions have been tested, sometimes to the extreme, which has highlighted areas where improvements could potentially be made. The area of most concern is notices relating to critical events such as Events of Default and Termination Events.

In 2023, ISDA published amendment language - Amendments to the Notices, Illegality and Force Majeure Event Provisions of the ISDA Master Agreement - which, amongst other things, adds email as a means of delivering notice of default. This amendment was published following member feedback related to the Covid-19 pandemic and recent global sanctions. The amendment particularly aims to address the situation where the specified notice methods and details, especially for physical delivery, in the ISDA Master Agreement are difficult, dangerous or impossible to use.

Another difficulty encountered by those serving notices is not having the most up-to-date notice details for their counterparty. Some research was undertaken by ISDA into notices served in relation to the administration of Lehman Brothers International Europe – they estimated that around 180 notices went to only the old address, which had been vacated four years previously. Some were sent to the old address and the new address, clearly in an attempt by counterparties to deliver wherever they could in the hope of improving chances of at least one method of delivery being deemed effective.

Unfortunately there are problems with using multiple delivery addresses and methods – it can be difficult to determine which avenue for delivery first constituted effective delivery. If notice is sent by email (alone or together with other methods) there can be potential problems here too. How do you evidence effective time and date of effective delivery when no third party is involved? What if the email address of the intended recipient ceases to exist – particularly if the email address relates to a named individual rather than an email address for a particular role or distribution group within an organisation?

There are many scenarios that can give rise to potential uncertainty and dispute over whether and when a notice is deemed effective. In the case of critical notices served in relation to Section 5 and 6 of the ISDA Master Agreement, this is particularly problematic. Certainty is very much needed to allow parties to take consequent action at the right time bearing in mind grace periods and, importantly, the calculations for valuations required for close-out amounts to be determined accurately.

**ISDA has been exploring and designing a new technological and legal mechanism for the delivery and effectiveness of notices under the ISDA Master Agreement: an online platform to be known as the "ISDA Notices Hub".**

## The Notices Hub

ISDA has been exploring and designing a new technological and legal mechanism for the delivery and effectiveness of notices under the ISDA Master Agreement: an online platform to be known as the "ISDA Notices Hub". The proposal aims to provide market participants with a safer and more efficient method for delivering and receiving critical notices under the ISDA Master Agreement, generally providing users greater control in the face of counterparty default.

The centralised platform will also allow market participants to update their physical notice details in one place, easing the administrative burden of instead having to update on a counterparty by counterparty basis. Initially, the platform would cover notices relating to Termination Events and Events of Default (Section 5 and 6 notices), but ISDA plans to extend its scope to deal with other notices under the ISDA Master Agreement and potentially also to similar notices under non-ISDA agreements.

## What would need to be changed for an organisation to use the Notices Hub?

Whilst considering the improvements and benefits that the Notices Hub aims to offer, market participants should also be conscious that in order to fully benefit from the hub, improvements may need to be made to the organisation's relevant internal processes, systems and policies to ensure (i) access to the hub is optimised and (ii) notifications of delivered notices on the hub can be received in the best and most effective way possible.

In order to make best use of the Notices Hub, an entity needs to be confident that email and other notification methods will always be received by the right people. For entities that already use centralised email distribution lists for important notices, rather than named individuals, there may still be an internal requirement for others in the organisation to be copied – e.g. some businesses require termination/close-out notices to be copied to the general counsel or head of treasury. Entities will also need to make sure that the various notification details and other details required to access the Notices Hub are updated as the business evolves or better still, to future-proof the details to withstand changes within the organisation.

## Some key features of the Notices Hub

- "instantaneous" and effective delivery/receipt of notices via online platform (with time and date stamped evidence of delivery)
- ability for market participants to update physical notice details for ISDA Master Agreements with all counterparties in one centralised place
- the platform will be provided by S&P Global Market Intelligence's Counterparty Manager platform which is expected to be free to use for buy-side (dealers pay a subscription fee)
- a recipient of notice on the Notices Hub would have "immediate" access to the notice, via various technological channels, "controlled" by the recipient, not the sender
- instant alerts - market participants elect how they wish to be "notified" of a notice delivered to them on the Notices Hub - by email, by SMS and possibly other means
    - each method could potentially be to a number of contacts - individual or centralised
    - parties can choose to designate specific third parties (e.g. a security trustee or guarantor) to access a copy of the notice/receive alerts
- allow communication from resolution authorities to counterparties of financial institutions
- adherence/implementation of the Notices Hub can be by three methods:
    - ISDA protocol (multilateral)
    - Amendment agreement (bilateral)
    - Incorporation in new ISDA Master Agreements (using ISDA published template language)

Note however that this process is intended to be facilitated by the Notices Hub, as a six-monthly verification process will prompt users to update details. In summary, use of the Notices Hub is likely to prompt some changes, albeit positive, to the way such important notices are received, delivered and dealt with within an organisation.

ISDA's letter emphasises that users should not need to rework their IT systems in order to use the Notices Hub, unless they wish to make use of optional API functionality to draw information directly into their internal systems.

## What next?

ISDA has stated that it will create the Notices Hub only if there is sufficient support from the market to adopt it. A period for members to provide 'pre-build' indications of support, as well as for derivatives users which are not ISDA members to provide feedback on the proposal, has recently closed, with the current timeline indicating a proposed 'go live' date in early 2025.

To provide reassurance as to the legal effectiveness of the Notices Hub, ISDA plans for it to be backed by legal opinions from around 70 jurisdictions. So far, opinions from around 60 jurisdictions have been received by ISDA indicating no major impediment to effective delivery of a notice via the Notices Hub.

# DRAFTING FOR EXTENSION OPTIONS – THE LMA EXTENDS A HAND

Extension options, which give the borrower the option to request an extension to the maturity of a facility, have been a common feature of investment grade working capital facilities for many years. Increasingly onerous capital requirements for banks, amongst other things, have made access to committed funding for more than five or so years for the average borrower almost impossible. The extension option offers borrowers the possibility to extend the maturity of their facilities for a year or two on the same terms, thereby delaying the need for a formal "amend and extend" or full refinancing, without lenders having to make any upfront commitment (and incur the increased capital costs that go along with that). In short, everyone is a winner.

While used extensively in the market, there has, until recently, been no template drafting available for extension options. That has now changed with the LMA having published a form of extension option drafting.

The LMA drafting is neither conceptually difficult nor particularly controversial. It adopts a structure which will be familiar to most market participants and broadly reflects market practice, although it is acknowledged that the negotiated terms of individual extension options can vary. Below, we provide an overview of the LMA's new drafting and consider a few key points for borrowers to keep in mind when looking to incorporate an extension option based on the new LMA form.

**The LMA's new extension option drafting adopts a structure which will be familiar to most market participants and broadly reflects market practice, although it is acknowledged that the negotiated terms of individual extension options can vary.**

## Overview of the LMA's extension option drafting

The LMA's extension option drafting is presented as a slot-in rider, intended to be used in conjunction with the LMA's investment grade recommended forms.

The rider reflects the commonly agreed "+1+1" structure, whereby the borrower is able to request a one-year extension to the initial tenor of a facility on two separate occasions. The first request must be made within a specified period before the first anniversary of the agreement, and the second request must be made within a specified period before the second anniversary of the agreement.

The LMA drafting includes a form of extension request and makes the delivery of such extension request conditional on the absence of any Default/Event of Default and the material accuracy of the repeating representations. There is an option to make the extension itself subject to the same conditions, as well as subject to any outstanding fees having been paid.

Importantly, the extension option is uncommitted – the lenders are free to accept or reject a request from the borrower to extend the facility in question. If a lender rejects the request (or if a lender simply fails to respond to the request), then the termination date applicable to its whole commitment in the relevant facility will remain unchanged. There is no option for a lender to choose to extend only part of its commitment.

## Key points for borrowers

The new LMA drafting is refreshingly simple and there is little of particular concern from the borrower's point of view. There are, however, a handful of improvements which borrowers may wish to consider negotiating if offered an extension option mechanic on LMA terms.

- **Automatic nature of extension:** The LMA drafting contemplates that once the extension request has been delivered and provided that the specified conditions are met (for which, see the discussion above), the commitments of lenders who accept the request will automatically be extended on the extension date regardless of the number of lenders who accept and the proportion of the total commitments that they represent. There is no option for the borrower to withdraw the extension request if the extension is not accepted by all lenders, a right which the borrower may want to incorporate. Alternatively, and to the same effect, the borrower may wish to build an additional step into the extension process whereby it is required to formally accept the extension once notified of the level of acceptances, before the extension can take effect.
- **Removal or replacement of a non-consenting lender:** The LMA drafting does not give the borrower the option to remove and/or replace a lender who does not accept an extension request. This can be useful to the borrower in the event that less than unanimous acceptance is achieved. Where it is agreed that the borrower is to have the flexibility to manage the lending syndicate in this way, the details will need to be agreed, for example whether the borrower has the right to require the non-consenting lender to transfer its position to a third party of the borrower's choosing, or whether the existing lenders in the syndicate are to have a right of first refusal on a pro rata basis.
- **Flexibility of the extension:** The LMA drafting permits the borrower to request a one-year extension before the first anniversary of the agreement and either a one-year extension (in the case of already extended commitments) or two-year extension (in the case of non-extended commitments) before the second anniversary of the agreement. Borrowers may want to think about whether there should be additional flexibility to request either a one- *or* two-year extension before the second anniversary of the agreement in respect of non-extended commitments.
- **Extension fees:** The LMA drafting contains a placeholder for extension fee arrangements, in recognition of the fact that there are different approaches adopted in practice. There are broadly two options available to borrowers – either to agree a fixed fee upfront or to leave the fee to be agreed at the time the extension option is exercised. This is a commercial point; both options are seen in practice. Bearing in mind that the option is non-binding on the lenders (meaning that in situations where there is concern about the success of the extension, any specified fees might fall to be negotiated in any event) there is possibly little to choose between them.

The extension option drafting is a welcome addition to the LMA's documentation library. Helpfully, the drafting has been kept simple and reflects the framework which is widely used in the market, but acknowledging that the terms of extension options can vary in practice and that the LMA drafting may need to be amended on a case-by-case basis. For further background on extension options, readers are referred to our ACT Borrower's Guide to the LMA's Investment Grade Agreements.

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# MANDATORY TAX DISCLOSURE RULES: THE LMA'S UPDATED DAC6 GUIDANCE NOTE

The LMA's updated DAC6 guidance note, published in early May 2024, considers when the duty to report transactions to tax authorities under the EU Directive known as "DAC6" and more recent UK regulations could apply to facility agreements and includes three optional Riders to address concerns the finance parties might have. Below, we outline the rules, provide an overview of the LMA's note and discuss our suggested approach.

## What is required under DAC6 and the UK regulations?

DAC6 and the UK regulations require that certain arrangements are reported to tax authorities. The reporting obligation is primarily on intermediaries (which could include finance providers) although taxpayers could, in certain circumstances, also be required to report. DAC6 targets cross-border arrangements which meet one of the hallmarks set out in the Directive. These hallmarks are divided into five sets (A to E). Hallmark set D mirrors what is covered under the UK regulations (which have no equivalent of DAC6 hallmark sets A, B, C or E). So, the scope of the UK regulations is narrower.

## What does the LMA's note say?

In its original form, the note considered when finance parties could be subject to reporting obligations under DAC6. It was updated in May 2024 to also refer to the UK regulations. The note focusses on two points: when standard confidentiality provisions could make a loan agreement reportable under DAC6 (addressed by Rider A) and when a loan agreement could finance or form part of wider arrangements that are reportable under DAC6 or the UK regulations (addressed by Riders B1 or B2).

## What approach is suggested in respect of the Riders?

Borrowers should generally resist the Riders as unnecessary in most transactions. The note itself says that the *"LMA has no immediate plans to introduce [the Riders] into its recommended forms of documentation and is not recommending their adoption"*.

- **Rider A is intended to override confidentiality obligations where they could otherwise create a DAC6 reporting risk.** This should rarely be needed; the LMA's note itself envisages that Rider A would be used only in limited, rather unlikely circumstances.
- **Riders B1 and B2 are alternatives.** They should not be used together and, in most vanilla lending transactions, neither is required.
- **Rider B1 confirms that no reporting is required under DAC6 or the UK regulations.** It would shift the cost of penalties for a finance party's failure to report on to the borrower. The risk is hard to quantify; multiple finance parties could be subject to penalties under different rules in the EU and UK.
- **Rider B2 requires the borrower to share advice on DAC6 or the UK regulations and reports thereunder.** The undertaking is far too broad. It would even require the borrower to share advice where it is contractually prohibited from sharing it, and also legal advice (thereby losing privilege) which is unprecedented in standard LMA wording. So, as drafted, it is not acceptable.

**Borrowers should generally resist the LMA's DAC6 Riders as unnecessary in most transactions.**

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# KEY CONTACTS

If you would like to discuss any of the above in more detail, please contact your relationship partner or email one of our Treasury Essentials team.

You can find previous editions of Treasury Essentials here.

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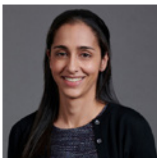

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