FUNDS INSIDER

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Foreword

Welcome to the Spring edition of Funds Insider, our quarterly publication focusing on hot topics across a wide range of practice areas of particular interest to private capital clients.

This edition will cover:

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- UK Real Estate top 10 key predictions for 2023
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- An easy way to list securities on the Luxembourg Stock Exchange

This edition is being published against the backdrop of fresh turbulence in the financial services sector with the demise of FTX and SVB, as well as the historic acquisition of Credit Suisse by UBS. Time will tell if the stress can be contained but the pressures arising from the continued inflationary environment we are in mean that it is now a time for private capital investors to be extra vigilant and seize the opportunities that arise out of a volatile market.

We hope you enjoy reading this edition of Funds Insider and please do get in touch if you have any feedback or if there are any topics that you would like us to cover in future editions.

Funds Insider

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Material adverse change clauses in finance documents

UK and US perspective

By Olga Galazoula, Jacques McChesney and Charlotte Harvey

As the economic headwinds indicate that borrowers will continue to face financial pressures in 2023 and beyond, lenders are seeking ways to exercise more leverage as "covenant-lite" facilities prevail.

At times of increased stress and distress, we tend to come back to the same question: is it possible for a lender to rely on a material adverse change clause in circumstances where the borrower is experiencing financial difficulty due to acutely adverse prevailing macroeconomic conditions?

This article aims to serve as a brief reminder of the principles underpinning this legal concept.

Where are MAC clauses used?

The use of material adverse change (MAC) clauses is common in various financial contexts, including loan agreements and mergers and acquisitions (although its use in M&A is not the focus of this article). In the loan agreement context, the concept of a MAC is generally used:

i. as an **event of default** (the Loan Market Association's standard drafting provides that a MAC event of default can be triggered in various circumstances, including where there is a material adverse effect on *the business, operations, property, condition (financial or otherwise) or prospects of the borrower's group taken as a whole);*

ii. in the borrower's **representations and warranties** to the lender (for example, at the time of signing the facility agreement, the first drawdown and subsequent drawdowns, as well as on each interest payment date); and

iii. in a wider context and in the variation concept of material adverse effect, to **introduce a materiality threshold** to certain (typically factual) covenants, representations or warranties made by the borrower (for example, by qualifying that a default will occur only if the breach is likely or reasonably likely to have a material adverse effect).

A MAC event of default is a potentially powerful tool: proving that a MAC event of default has occurred will generally permit a lender to cancel any outstanding commitments and accelerate and demand immediate repayment of all amounts accrued and outstanding (among other things). However the road to successfully arguing that a MAC has occurred is not a well-travelled one. Few MAC clauses have been tested before the English courts and, as a result, there is little guidance on how they are likely to be interpreted or indeed enforced.

How have MAC clauses been interpreted by the English courts?

The English courts have generally been reluctant to provide guidance on enforcement of MAC clauses, not least because each case will vary according to its facts and the way the MAC clause has been drafted (on account of their being heavily negotiated).

Nevertheless, as a starting point, we know that a MAC event of default contained in an English law-governed agreement will be interpreted in accordance with general contract law principles. This means that a MAC clause will be capable of being enforced only if it clearly expresses the intention of the parties to the agreement, which the courts will assess by reviewing the agreement as a whole. Whether a material adverse change has occurred will then be determined as a matter of fact. In this regard, the High Court set out some general guidance for the interpretation of MAC clauses in a leading case, *Grupo Hotelero Urvasco SA -v- Carey Value Added SL (Grupo).*[1]

General Guidelines

Grupo concerned a MAC representation clause which provided that "there has been no material adverse change in [the obligors'] financial condition (consolidated if applicable)" since the date of the loan agreement. In alleging that the borrower was in breach of this representation, the lender argued that the term "financial

1 *Grupo Hotelero Urvasco SA -v- Carey Value Added SL* [2013] EWHC 1039 (Comm).

condition" should not be limited to particular parts of a company's accounts (for example, net current assets or profits), rather it should encompass all aspects of a company's finances in addition to the state of the markets in which the company operates. The Court dismissed this argument and held that there had not been a MAC to the borrower's financial condition. While the decision in Grupo turned on the wording of the clause in question, the Court provided some guidelines for the interpretation of MAC clauses that may be applied more generally:

i. If a MAC clause requires a change in the "*financial condition*" of the borrower, the change will be assessed *primarily by reference to the borrower's financial information* (ie interim financial information and/or management accounts), although other compelling evidence may be accepted (an example of such evidence in *Grupo* was that the borrower had ceased to pay its bank debts). There is a distinction between the terms "financial condition" and "business or financial condition", as the latter is broader in scope. The Court's focus on the specific wording of the MAC clause indicates that each clause must be reviewed carefully in order to understand its scope and parameters. For example, does the clause relate only to certain obligors in the borrower's group, or does it relate to the group as a whole? Does the change have to affect the borrower's (or the group's) payment obligations, or its obligations in general?

ii. An adverse change will be material only if it *significantly* affects the borrower's ability to perform its obligations under the relevant agreement.

iii. A *lender cannot trigger a MAC clause based on circumstances of which it was aware* at the time of entering into the relevant agreement, unless these circumstances "worsen in a way that makes them materially different in nature".[2] This is particularly relevant for lenders who are considering calling a MAC event of default on the basis of the prevailing economic climate: if, for example, a loan agreement was entered into while the economy was already experiencing a downturn, it would be more difficult to argue that the lender was not aware of these specific economic circumstances.

iv. Any change relied upon for the purposes of enforcing a MAC clause must not be *temporary*.

v. The party seeking to enforce the MAC clause has the *burden of proving that a MAC has occurred*.

In certain circumstances, an event does not have to have an objectively adverse effect. For example, in *Cukurova Finance International Ltd -v- Alfa Telecom Turkey Ltd*,[3] a MAC event of default was drafted as follows:

> *Any event or circumstance which in the opinion of [the lender] has had or is reasonably likely to have a material effect on the financial condition, assets or business of [the borrower].*

2 *Grupo Hotelero Urvasco SA -v- Carey Value Added SL* [2013] EWHC 1039 (Comm) [362].

3 *Cukurova Finance International Ltd -v- Alfa Telecom Turkey Ltd* [2013] UKPC 2.

The event relied upon by the lender to enforce this clause was the making of an arbitration award that could potentially result in significant damages being awarded against the borrower. It was agreed that the drafting of such a clause did not require an event to have an adverse effect from an objective perspective: all that was required in this case was for the lender to believe that the event had such an effect and for this belief to be both honest and rational. As a result, the lender was able to successfully rely upon the MAC event of default.[4]

What is also clear is that a MAC clause must be *triggered by a specific change*. In *Levison -v- Farin*, sellers of a target company warranted that "there shall have been no material adverse change in the overall net asset value of the [target] company". This was relied upon by the buyers even though they had been informed prior to the acquisition that the target was running at a loss. The court held that the buyers were entitled to damages for breach of the warranty, because a 20% decrease in net asset value was material and this was not a "normal trade fluctuation": it was a MAC that had not been covered by the general disclosure of the cause of future losses prior to signing.[5]

Extreme Circumstances

While the interpretation of a MAC clause is likely to depend heavily on the way in which the MAC clause is drafted and the specific facts of the case, there are of course *circumstances in which a borrower's financial condition has so obviously declined that its ability to repay a lender is in serious doubt* and invoking a MAC event of default is appropriate (in order to prevent a lender from "throwing good money after bad"[6]). For example, if a borrower's assets are frozen such that it defaults on interest payments and imminent insolvency becomes a real possibility, the court may decide that there are no reasonable grounds for challenging a MAC event of default (as it did in *BNP Paribas SA -v- Yukos Oil Co*,[7] where the freezing of US$3 billion of a borrower's assets caused it to default on its interest payments).

Can we look to the US courts for additional guidance?

While there is some US case law in relation to MAC clauses, the majority of such cases relate to MAC clauses in acquisition agreements because

4 This approach was confirmed by *Lombard North Central Plc -v- European Skyjets Ltd* [2022] EWHC 728 (QB).

5 *Levison -v- Farin* [1978] 2 All ER 1149.

6 *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 (Comm) [336].

7 *BNP Paribas SA v Yukos Oil Co* [2005] EWHC 1321 (Ch).

MAC event of default clauses are not typically included in US leveraged finance documents (due to the shift towards using high-yield structures). In the M&A context, the New York and Delaware courts have generally set the bar high when it comes to finding that a MAC has occurred. Indeed, only one Delaware Chancery Court case to date has held that a MAC has occurred, thereby enabling a buyer to terminate a merger agreement.[8] Like their UK counterparts, US MAC cases depend heavily upon the circumstances of the case and the wording of the MAC clause in question.

Are there any risks to watch out for in seeking to rely upon MAC events of default?

In the light of the above, using a MAC event of default clause to "default" a borrower is not a straightforward process and it gives rise to the possibility that a borrower may sue for damages for breach of contract (particularly if a lender's unjustified acceleration of a loan leads to cross-defaults in other finance documents). Given the nuances of interpretation, a court judgment may often be the only way to determine whether a MAC has occurred, which can be time-consuming, expensive and impractical. You should therefore carefully consider reputational and economic implications before taking this route. In the light of all the above, the circumstances in which it can provide a bullet-proof, or even sufficiently robust, means to trigger an event of default (and possibly a consequent acceleration of financial liabilities) are likely to be specific and limited.

8 This was the case in *Akorn, Inc -v- Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

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Secondaries transactions in the funds sector

General partners leading the charge

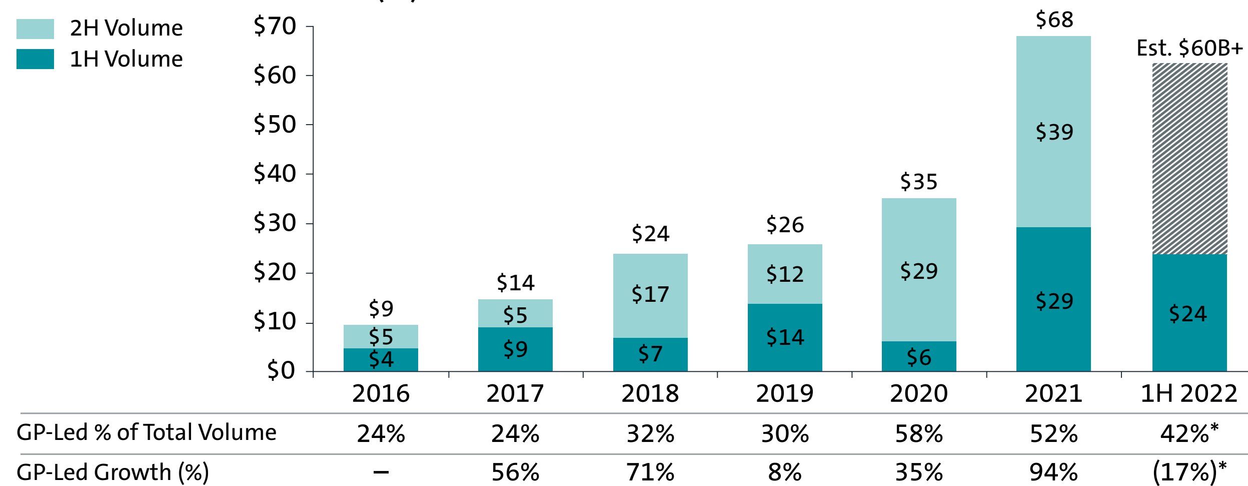
By Nick Goddard, Samantha Hedley and Nikita Pandit

Prospects

Secondary transactions offer liquidity and flexibility to the funds sector.

Secondaries led by general partners (GPs) have become an integral feature of the fund secondaries market. In the first half of 2022, they represented 42% of all secondary transactions, compared with 24% in 2017[1].

GP-Led annual transaction volume ($B)



	2016	2017	2018	2019	2020	2021	1H 2022
GP-Led % of Total Volume	24%	24%	32%	30%	58%	52%	42%*
GP-Led Growth (%)	–	56%	71%	8%	35%	94%	(17%)*

* Represents 1H volume growth year-over-year

What's more, many believe the GP-led segment of the market is poised for further growth and is likely to exceed US$200 billion by 2025[2].

1 *Jefferies, 1H 2022 Global Secondary Market Review (July 2022).*
2 *Lazard Private Capital Advisory, Sponsor-led Secondary Market Report 2021 (January 2022).*

Structures

A GP-led secondary transaction comes in many forms. The main options are as follows:

- Direct secondary – the acquisition of a fund's entire portfolio of assets by a new buyer who will also assume responsibility for managing those assets. The existing GP will retire from its role.
- GP spin-out – a spin-out of a captive GP from a parent platform, such as a bank, insurance company or a larger GP.
- Tender offer – a buyer tenders for all or a portion of existing investor interests. This route, which aggregates investor interests, will often achieve a higher price for the sellers than separate sales by individual investors.
- Strip sale – a certain percentage of a fund's interests in assets are sold to a special purpose vehicle managed by the same GP. This route is a useful way of raising capital. It can pave the way for accelerated investor distributions. It can also be structured such that the sale proceeds can be retained by the fund and reinvested in the portfolio.
- Single-asset continuation fund – the sale of one asset to a continuation vehicle managed by the same fund manager at a price agreed with the secondary buyers. Existing investors may opt to sell if they want to "cash out", and/or they need the liquidity and a chance to rebalance their portfolios. Alternatively, they may choose to roll over into a new vehicle if they take the view that the GP's continued management of the asset and/or future market conditions will lead to higher pricing.
- Multi-asset continuation fund – the sale of portfolio assets to a vehicle managed by the same fund manager at a price agreed with the secondary buyers. Again, this offers investors the choice of exiting the fund, or rolling their capital over into the new vehicle.
- Stapled secondary – the buyer of the existing assets also commits to make a primary commitment to a new fund, which is managed by the same GP.

However, common to all structures is the fact that a secondary buyer acquires existing investments. These will often reside in a new holding vehicle.

Motivations and incentives

The motivations and incentives for sponsors and investors of GP-led secondary transactions include the following:

For GPs/sponsors

- Existing investors can reduce their exposure to a legacy fund, thereby creating capacity to invest in the GP's new fund offering.
- Fresh capital for follow-on investments is raised.
- A buyer's market may favour a later sale. For example, the use of continuation vehicles during the pandemic, when asset values were depressed, allowed sponsors and investors to weather the economic downturn. In any event, a later sale should afford more time to enhance the value of the assets.
- In a seller's market, it makes sense to hold on to known, and proven, high-quality assets.

For new investors

- The holding period (before gains are realised) may be much shorter, especially for single-asset vehicles.
- They can bypass the higher-risk discovery stage at the beginning of the PE investment by investing in a "tried and tested" product.
- For the same reason, there is a reduction of "blind pool" risk and less emphasis on the due diligence process.
- Involvement in secondary as well as primary funds promotes diversification, a spreading of risk, as well as a more consistent cash flow.
- Buyers will get to know the GP/sponsors. Developing this relationship may give them priority access to subsequent fund launches/transactions.

For existing investors

- The big question is: to roll over or not to roll over? Typically, existing investors have three options: (i) sell their interest and receive their pro rata share of the cash purchase price; (ii) roll over their pro rata interest in the existing fund into the new vehicle; or (iii) in some instances, opt for a combination of (i) and (ii), depending on how the transaction is structured. This third option means investors can benefit from the option to exit the fund while retaining exposure to the particular assets in question.
- Sellers will benefit from increased liquidity, and the opportunity both to invest realised capital elsewhere and to rebalance their portfolios.
- Rollover investors are backing a known management team and assets that may continue to generate healthy returns and will therefore share the same motivation/incentives as the new investors, as outlined above.

The economics

The Net Asset Value (NAV) of the assets being transferred is often historical, having been set at the outset of the deal. The deal may take a considerable time to complete. If the relevant market is moving upwards during this period, the NAV may look conservative by the time the deal closes. Commentators have pointed out that this arrangement favours new investors but the issue of fair pricing can be addressed using various strategies (see "Stumbling blocks and how to navigate them" below).

The costs of the transaction will not be met by the GP. Instead, often the sale costs will be paid by the main fund, with the costs of setting up the continuation fund being met by both new investors and rolling investors.

GP-led secondary funds tend to have lower management fees than primary funds. So, while a smaller private equity fund might have a management fee of, say, 2% p.a. of committed capital, the figure for a GP-led secondary fund might be, say, 0.5% to 1.25% p.a. of drawn capital. Inevitably, the negotiated figure will depend on the particular circumstances of the transaction, including the size of the fund and the expected role of the fund manager in the further development of the investment, as well as market practice generally.

New investors will want to see that the GP continues to have "skin in the game", for example by reinvesting any carried interest and GP commitment received on the sale into the new vehicle. In practice, a rollover of crystallised carry may mean a very significant commitment on the part of the GP, well in excess of its original investment.

The carried interest percentage may also be lower than the usual 20%, although it may ratchet upwards on a performance-related basis. There may also be a higher hurdle to overcome before the GP can begin to receive carried interest.

Rollover investors will look carefully at their tax positions. The deal may be structured to ensure that no tax loss or gain is crystallised, and the original cost basis is retained. This is known as a "tax-free roll". An "after-tax roll" is an alternative structure, where the rollover amount is net of any tax withheld or payable.

Stumbling blocks and how to navigate them

Investors in primary funds who are faced with the option to exit or roll over have voiced concerns regarding GP-led secondaries. These focus on three main areas: pricing; timing; and conflicts. However, given the stability of the secondaries market, reflected in the increasing number of high-calibre players and the sheer volume of secondary transactions in recent times, these concerns can be overstated. To navigate them, it makes sense for GPs to engage with the fund's Limited Partner Advisory Committee (LPAC) as early as possible in the process.

Regarding **pricing**: existing investors contemplating an exit will be keen to ensure that the assets being acquired by the secondary vehicle are priced fairly, in the absence of an exit mechanism such as an open market sale or IPO. This is especially so with stapled secondaries, where new investors will be contributing capital to a new fund managed by the GP, as well as participating in its secondary vehicle.

GPs seeking consensus on pricing would be well advised to provide details of relevant valuations, financial models and projections to the LPAC for wider dissemination. If there has been a bidding process, giving an overview of bids received might also be helpful. Additionally, the guidance released by the Institutional Limited Partners Association (the ILPA Guidance) suggests that, in complex restructurings, a fairness opinion from an independent financial consultant might also provide reassurance.

Regarding **timing**: tight timeframes and momentum on these transactions are important.

It would be sensible for GPs to communicate the rationale for the transaction, the process and the projected timings to the LPAC as soon as practicable. The ILPA Guidance suggests that the GP might consider engaging a secondaries adviser to support the process and to assist in communicating information to investors (eg in relation to any bids received). In terms of a concrete time frame, the ILPA Guidance recommends 20 business days for existing investors to evaluate the sale/purchase information and to make their choice.

Regarding **conflicts of interest**: these will arise among existing investors, new investors and the GP. This is especially so where new investors are offered different terms from those offered to rollover investors. There should be detailed disclosures to investors regarding these issues; attempts to mitigate conflicts should be considered and, where possible, made; and any conflicts should be approved by the fund's LPAC or otherwise appropriately approved in accordance with the fund's constitutional documents.

Conclusions

The market view has developed in recent years in relation to GP-led secondary transactions. Gone are the days when a continuation fund was viewed solely as a way to simply "move" unrealised portfolio investments out of a fund in distress – struggling to make exits and/or unable to return capital to its investors – or nearing the end of its life.

GP-led secondaries are now increasingly a valuable feature of the investment fund environment, with a dramatic increase in transaction volumes over the last few years. Opting for a GP-led secondary transaction provides fund managers and investors alike with many and various opportunities. Particularly useful is the chance to extend the holding period of the fund's assets in order to maximise value, as well as to gain added liquidity within a large and maturing market.

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UK Real Estate top 10 key predictions for 2023

By Sarah Sivyour, Claire Dutch, Alison Murrin and Kathryn Hampton

Well, last year was certainly a busy one in Whitehall, but – now that the dust has settled – what does this year have in store for the real estate industry? Will "planning gain" be revolutionised? Will communities have more say? Will any houses be built or will developers be blamed for everything? In the face of economic uncertainty, real estate owners and investors will need to get to grips with the changing regulatory landscape. The first hurdle in 2023 will be for overseas entities. If they own land in the UK, they must register their beneficial owners at Companies House before the end of January 2023 or face draconian consequences.

Here are our top ten predictions on what lies ahead this year:

1. The Levelling-up and Regeneration Bill

Already causing havoc within the Tory party, the "LURB", as it has become known, is due to become law later this year. Its raft of changes will give councils more power against developers that do not have good build-out rates. Definitely more sticks than carrots there. Some of the key reforms are:

- replacing CIL with a new Infrastructure Levy to capture land-value uplift;
- punishing developers with slow build-out rates, and new requirements for developers to submit a development progress report to the council so it can closely monitor build-out rates;
- putting a stronger emphasis on aesthetic appeal and good quality design;
- community land auctions which allow landowners to grant options over land with a view to the land being allocated for development in the local plan. Councils will then have the power to exercise or sell the option, allowing them to capture some of the increased value that would result from the allocation;
- requiring water companies to upgrade sewage treatment works by 2030 to unblock permissions in sensitive areas affected by nutrient pollution;
- compulsory registration of short-term rental properties; and
- giving more power to communities (including street votes, allowing residents to propose and vote on development in their street).

The Bill has now gone to the House of Lords and is due to have its second reading on 17 January 2023.

2. Renters Reform Bill

Michael Gove has indicated that this will progress in 2023. Among other things, it will scrap section 21 – no fault evictions – under the Housing Act 1988. Section 21 is reassuring for landlords who can be safe in the knowledge that, aside from the relevant notice period, they are virtually guaranteed a possession order. To address this, the Bill promises to strengthen landlords' grounds for possession.

3. New NPPF

As you know, much of the planning system is embedded in policy, as well as law. Alongside the infamous LURB comes an overhaul of the National Planning Policy Framework. Published just before Christmas, the consultation prospectus sets out more detail on the reforms, including:

- making delivery rate and developers' bad behaviour material considerations when determining planning applications (so they're more likely to be refused planning permission);
- requiring developers to explain how they will maximise a development's absorption rate to minimise land-banking;
- allowing authorities to refuse to determine planning applications submitted by applicants with a bad track record (this is not defined, but probably refers to planning breaches and/or poor rates of delivery);
- "name and shame" measures, where data will be published on developers who fail to build out according to their commitments;
- council-friendly changes to local planning policy to encourage faster adoption of local plans, including the relaxation of housing land supply requirements;
- changes relating to climate change and energy, including support for the renovation of buildings to improve their energy efficiency; and
- the scope of new National Development Management Policies, which will set out how councils should determine planning applications. The detail will be included in a later consultation.

The consultation closes on 2 March 2023, so there's plenty of time to comment. The changes will be brought in quickly (by spring 2023) and a further, fuller review will be conducted "in due course", once the LURB becomes law. This will look at issues such as infrastructure, climate change and a new financial penalty for slow build-out rates.

4. Economic Crime Bill

Following the enactment of the Economic Crime (Transparency and Enforcement) Act 2022 (ECTEA 2022) last year, the Economic Crime and Corporate Transparency Bill will build in further measures to ensure corporate transparency in the UK. The Bill will reform the role of Companies House and improve transparency over UK companies and other legal entities in order to support national security and combat economic crime, while delivering a more reliable Companies Register to underpin business activity.

The Bill includes a number of changes to the role of Companies House, including:

- introducing identity verification for all new and existing registered company directors, People with Significant Control, and those delivering documents to the Registrar;
- broadening the powers of the Registrar of Companies House so that the Registrar can become a more active gatekeeper over company creation and the custodian of more reliable data, including new powers to check, remove or decline information submitted to, or already on, the Companies Register;

- providing Companies House with more effective investigation and enforcement powers and introducing better cross-checking of data with other public and private sector bodies. Companies House will be able to proactively share information with law enforcement bodies where they have evidence of anomalous filings or suspicious behaviour; and
- enhancing the protection of personal information provided to Companies House.

The Bill makes some changes to limited partnerships, which include tightening up registration requirements and introducing wider transparency requirements. The Bill also strengthens anti-money laundering powers, enabling better information sharing about suspected money laundering, fraud and other economic crimes.

There are two significant amendments that relate to the UK's Register of Overseas Entities (ROE). Firstly, when applying to Companies House for registration on the ROE, an overseas entity will need to provide details of all the registered land that it owns in the UK. This could impose a greater administrative burden where the overseas entity has significant land holdings in the UK. The second amendment will mean that all trustees are automatically registrable on the ROE if they meet any of the beneficial ownership conditions under ECTEA 2022. Currently, a non-UK trustee legal entity will qualify as a registrable beneficial owner only if it provides trust services and the provision of trust services is a regulated activity in the entity's home jurisdiction.

It is also worth remembering that the transitional period for an overseas entity that already owns land in the UK (and was registered as proprietor prior to 1 August 2022) expired on 31 January 2023. Failure to register will have draconian consequences as the overseas entity will not be able to transfer the land, grant a lease of more than seven years or grant a legal charge over the land, and is at risk of significant criminal penalties.

5. Compulsory Purchase Reform

As part of its "Levelling Up" agenda, the Government wants to break down the barriers around compulsory purchase and give communities more power to acquire and rejuvenate land to boost growth. The Law Commission has been tasked with a comprehensive review of compulsory purchase procedure and compensation. The aim is to bring the mind-numbingly complex compulsory purchase legislation under one Act and make it easier to use and understand.

The Commission will try to modernise the drafting; repeal any out-of-date provisions and rectify any technical inconsistencies. It is expected to take three years to complete the review and a large part of this will be engagement with key stakeholders to collate and critique new ideas. Watch this space for more in due course.

6. Product Security Act

This Act received royal assent on 6 December 2022, but most of its provisions are not yet in force and will be brought into force by secondary regulations. The Act amends the existing Electronic Communications Code to rectify some of the issues which have emerged from cases decided since the Code came into force in 2017. The Landlord and Tenant Act 1954 will be amended to align its rental valuation provisions for electronic communications leases with more operator-friendly provisions under the Code. The Act also seeks to extend upgrading and sharing rights to equipment installed before the Code came into force and to streamline the renewal of Code agreements.

7. The "Brexit Freedoms" Bill

Will 2023 see the enactment of the Brexit Freedoms Bill? Its proper name is the Retained Law (Revocation and Reform) Bill 2022. This Bill allows the UK to remove retained EU law. Under the Bill, any retained EU law not expressly preserved will automatically expire on 31 December 2023.

What are the implications for real estate? Many environmental laws are EU-derived, so some will be reviewed as part of this colossal exercise. The Bill would give individual ministers wide powers on these laws as they could amend them by statutory instruments (instead of repealing them). This process is subject to less scrutiny than primary legislation, so some are concerned that it could (especially if rushed through) lead to unintended consequences.

8. Building Safety Act – secondary legislation

There are various provisions of the Building Safety Act 2022 which are likely to come into force next year and which landlords and developers will need to plan for.

For owners of residential buildings over 18 metres high, there must be an "accountable person" who is responsible for repairing the structure and common parts of the building. The accountable person will have a statutory duty to manage building safety risks and provide information to the regulator.

The Act also introduces the concept of the "golden thread" to ensure that all the information obtained during the planning, construction and occupation of the building is collated, maintained and can be given to interested third parties. Furthermore, in order to recover the service charge from the residential leaseholders, the landlord will need to include certain prescribed building safety information in rental demands.

This is in addition to the current restrictions on recovery of the service charge for remediation of historical building safety defects and the new liabilities on current and previous building owners to remedy such defects under a remediation order or a remediation contribution order. In certain circumstances, it is possible to obtain an order against group companies, associated partnerships, majority shareholders and corporate directors of the responsible party.

The Act also gives the Secretary of State the power to set up a Building Industry Scheme. Developers and contractors who agree to undertake or fund the cost of remedial works to their buildings will be able to join the scheme. The Secretary of State will have the ability to prohibit those outside the scheme from undertaking development work if it is considered necessary to secure safety or building standards.

Over the recent holiday period, the Government launched another consultation on more fire safety measures. It is considering rules to mandate second staircases in new residential buildings over 30 metres high, and sprinkler systems for all new care homes. The consultation closes on 17 March 2023.

9. The Supreme Court's ruling on *Finch*

Last year saw some highly controversial cases which set LinkedIn and Twitter alight. This year, an important Environmental Impact Assessment (EIA) case is due to be heard by the Supreme Court (*R (Finch) -v- Surrey County Council*).

The judgment could have major implications for the development industry as it is about how far one has to go when assessing indirect environmental impacts. The planning permission in question was for the extraction of oil (but not its refinement). The county council had taken the view that the greenhouse gases that would be generated from the eventual combustion of the oil were not indirect effects of the proposed development. The ultimate use of the product was not part of the development proposal.

The Court of Appeal was split on the issue, but the majority said that the council's approach was lawful. We now wait to see what the Supreme Court will decide.

10. HM Land Registry (HMLR)

HMLR is continuing its progress towards a digital register. It launched the Digital Registration Service last year and on 30 November 2022 became "digital by default". As part of this process, it wants to move away from manually checking applications and is piloting a system for conveyancers to provide confirmation of the data as part of the application itself.

Ultimately, HMLR's goal is to reach the point of instantaneous processing so that applications to change the register are started before completion and the registration requirements are therefore dealt with as part of the conveyancing workflow. If this can be achieved, it will speed up registration and improve the efficiency of the land registration system.

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Loan markets 2023

What is in store?

By Dave Rome

This article is adapted from a series published/posted on LinkedIn during the last few weeks of 2022. The articles (some more than others) focus on the corporate lending end of the market but the message is undoubtedly relevant and applicable to other asset classes, including the leveraged finance market where many funds are active players.

Introduction

As we entered the first Covid-19 lockdown back in April 2020, I posted the following on LinkedIn:

"After a week like no other, a quick reflection on what's needed in the loan markets in the next few weeks and months:
Patience, common sense, flexibility but above all communication. If borrowers and lenders talk to each other it's going to be a whole lot easier. Stay safe everyone."

As we emerge from the depths of the pandemic, the economic fallout from it and other factors are all contributing to another choppy outlook for the debt markets, both loan and bond.

These economic headwinds point to a market where all lenders, whether banks or funds, will exercise more choice in terms of capital deployment, and borrowers may have to accept a slightly higher number of controls over a shorter tenor at a higher price.

The current market reminds me of late 2007/early 2008 when, though everyone knew something was up, no one was quite sure what was coming. The one clear exception is rising underlying rates, which will further complicate how the market evolves over the next few months and years.

There are four key pillars to any loan market deal – price, tenor, controls and liquidity. There is no one size fits all in the loan markets, but if previous downturns are an indicator then generally speaking we are likely to see some of the following trends:

- Innovation will occur
- Tenors and pricing will be under pressure
- Covenants will be testing, as well as tested
- Liquidity is key

This article seeks to look at each trend in turn.

Innovation – a loan market speciality

The loan market has always been a relationship-driven, highly negotiated market which lends itself to innovation. But never more so than in times of stress when lenders and borrowers structures and solutions that reflect the particular circumstances the market finds itself in.

Many such structures and solutions have survived the choppier markets which they were originally designed to serve and have become mainstream features of the market. Others may well make a comeback – see more below on an old favourite, the Forward Start Facility. Finally, given we are about to move into an era of high underlying rates, we may see new structures evolving especially in relation to covenants.

Examples of innovation which are now very much part of the mainstream market are amend and extend, acquisition spikes, accordions and +1s.

Utilisation fee structures came to the fore as liquidity became constrained during the global financial crisis with first-draw structures establishing a nice balance between classic backstop facilities and a borrower's need to draw down funds occasionally.

Bridge to bond facilities with duration fees and step-ups in margins have also become a regular feature, particularly for acquisitions. The bond markets, corporate and high yield, are experiencing their own issues at present, so I would expect more imaginative structuring of bridges for takeout markets in 2023.

All of the above and plenty of other structural changes will be key components of how loan markets remain at the forefront of corporate financing while economic headwinds persist.

More recently, the rise and rise of the sustainability linked loan (SLL) is a welcome evolution designed to reward borrowers for being more sustainable. We have seen more and more borrowers incorporate sustainability-linked elements into their core financing, and the structure is effectively already a mainstream feature of the market. I am not convinced they are perfect or that they drive sustainable behaviours, as opposed to merely reflecting them, but they are a welcome step and, with the market's ability to innovate, I think perhaps they will eventually be seen as one of the driving behaviours contributing to the fight against climate change and other social issues.

The final innovation I'd like to touch upon is probably my favourite – the forward start facility (FSF). A structure that gained prominence in the global financial crisis, it enables borrowers to lock in liquidity from supportive lenders, often extending the tenor of their financing. Those lenders committing to the FSF are rewarded with enhanced pricing and controls. Those lenders who do not commit are effectively left with the existing facility, with pricing and controls more than likely out of the market. The FSF is a very effective structure in a higher pricing environment when liquidity may well be tight, and as such it made a brief comeback during Covid-19. With the market set for a sustained period of instability, my bet is we will see many more FSFs in the next 12-24 months.

Choppy markets mean more negotiation. And with more negotiation comes innovation.

Pricing and tenors under pressure?

Credit markets are becoming increasingly difficult to navigate.

- The corporate bond market, the faster mover in terms of debt markets, saw shorter average tenors in 2022 and wider credit spreads. The all-in cost of borrowing has tracked rapidly north as underlying rates around the world have risen.
- The high yield bond market was largely inactive in 2022, but on reopening it proved expensive.
- The corporate loan market, being largely underpinned by relationship banking, is generally slower to react than bond markets. That said, as 2022 unfolded, there were some signs of shorter tenors being offered, as well as higher pricing (in terms of margin and fees).
- The leveraged loan market, again though muted in terms of volumes, has shown similar trends.

SONIA, the UK replacement for LIBOR is, at the time of writing, 3.43%. This development means, even if the negotiated pricing element of any loan deal has remained steady, the all-in cost of GBP drawn debt from banks and funds is considerably more expensive now than at the start of 2022 when SONIA was 0.19%. This is also true for USD and EURO loans with SOFR having moved from 0.05% to 4.3% and three-month EURIBOR from -0.547% to 2.25% over the same time period.

In the corporate lending environment, underlying rates aside, movements in terms of negotiated pricing and tenor have to date only really affected the crossover and stressed end of the market but the question is: will the status quo persist into 2023 or will we see shorter tenors and higher pricing across all credit grades and all asset classes?

As we embark on 2023 we are told by banks and funds that liquidity is readily available – banks are well capitalised and funds have cash to deploy. I do not doubt these statements are true, but now – more so than ever before – lenders will be selective.

Greater selectivity tends to lead to higher pricing and shorter tenors.

On pricing, in addition to margins and fees trending upwards, we may see greater emphasis on higher fees linked to utilisation. We will see support rewarded with structures such as forward starts (as highlighted above). Bridge to bond structures may also become more expensive given underlying takeout markets have become and will likely continue to be more expensive.

On tenors, will 3 be the new 5? Will +1s be aligned with shorter tenors only, or will they come at the end of deals rather than in the first 12/24 months? Shorter-term incremental liquidity lines will also bring average tenors down.

In my view, the answer to the above is that, in all likelihood, as with previous downturns, margins and fees will go up and tenors will become shorter across all credit grades. By how much will depend on a number of factors, including purpose of the loan, sector, credit standing of the borrower and, crucially, the strength of the relationship between borrower and lender.

Fair and balanced financial covenants can be a positive for both borrower and lender

Financial covenants tend to be an emotive issue for both borrowers and lenders.

The public leveraged market tends to shy away from covenants for various reasons. If any are negotiated, they tend to be incurrence-based. On the rare occasions a maintenance leverage covenant exists, it is complicated, with various EBITDA add-backs rendering it somewhat cosmetic.

That said, since the GFC and the advent of more debt funds/direct lenders into the largely privately held mid-market, we have seen a more robust approach to covenants in that part of the leveraged loan market. Long may this continue: well-drawn financial covenants are not something borrowers should be worried about.

The corporate loan markets are more receptive to covenants with one, or sometimes two or more financial measures that are tested quarterly or semi-annually.

I would argue that a fair and balanced covenant package is one that affords the borrower a sufficient level of headroom to operate without looking over its shoulder during the good times. In times of stress or concern, however, financial covenants, if well structured, will provide lenders (and indeed borrowers) with an effective early warning system. Returning to the central theme of this article, I would say they help to bring both sides to the table and encourage early communication.

With increasing headwinds, rising underlying rates, growing energy costs, persistent supply chain issues and subdued consumer demand, many businesses are already struggling and it is inevitable that financial covenants will continue to come under pressure. Some sectors will suffer more than others, but generally I'd expect:

- greater focus on financial information and budgets – forecasting will be trickier as volatility increases
- more waiver requests – evidence from Q3 and Q4 2022 suggests this is already happening
- more resets – a sensible forward look can create bandwidth for a borrower while keeping dialogue open
- greater focus on interest cover measures, including debt service cover where appropriate
- increased use of cashflow and liquidity covenants

  and possibly, in some segments of the market...
- more creative add-backs...

If covenants are, or are reasonably likely to be, breached, our advice to market participants is to get things out in the open as early as possible – effective information flow and honest communication are key to resolving issues concerning covenants.

Liquidity is key

Patience, common sense, flexibility, but above all communication.

If borrowers and lenders talk to each other it's going to be a whole lot easier.

This has been the unifying thread of this article and effective communication remains crucial to the efficacy of the market going forward, but the *key message* here is the importance of liquidity above all the other factors we have talked about.

There is little doubt that 2023 will be a challenging year for many loan market participants, be they borrowers, lenders or advisers. We are going to see some stress, and with stress comes the need to get round the table and talk things through. Old-fashioned sleeves-rolled-up-style negotiation – perhaps echoing the '70s, an energy crisis and plethora of industrial action...

As discussed above:

- we will see increased innovation, with products such as the forward start facility making a comeback
- pricing and tenors will come under pressure, especially in certain sectors
- covenants, often a huge negotiating issue, may need to be waived, reset or revisited

All of the above points are key to how the market evolves in 2023 but the one factor that has been and always will be the most important is liquidity.

The need for and provision of liquidity underpins everything we have talked about above. Cash is undoubtedly king, and access to liquidity remains crucial to a borrower's capital structure not least because it both pays the bills and underpins access to longer-term debt.

When I talk about the four key pillars of any loan market deal – price, tenor and controls are important, but liquidity is fundamental.

My advice would always be: pay an extra few basis points if need be, sacrifice a year in tenor, negotiate a well-balanced and sensible covenant package if all of this gets you the liquidity you need.

Within Ashurst Global Loans:

- we act for both borrowers and lenders
- we have lawyers who can advise across all product lines, all credit grades and all asset classes
- we have experience across all sectors and geographies
- as headwinds bite we have lawyers with extensive experience of previous downturns
- we have lawyers who can help mitigate the effects of stress or distress and...
- we have ex-bankers in the team who understand the dynamics of choice and capital deployment.

We have you covered!!

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Sustainable finance

Key challenges and takeaways

By Anna-Marie Slot, Global ESG Partner

Introduction

Sustainable finance has become a hot topic in the world of finance and capital markets in recent years, as public and private financing of projects in line with borrowers' and issuers' Environmental, Social and Governance ("ESG") commitments has exploded. Since the signing of the Paris Agreement in 2015, more than 100 countries have committed to net zero emissions targets, and by mid-2022 more than one-third of the world's largest publicly traded companies had done the same. Financial institutions have engaged with various policies to enshrine ESG commitments in their own lending targets and in the carbon emissions policy linked to those targets, and both retail and institutional investors are increasingly looking towards the financial markets as an important lever to achieve those targets.

The UK was an early leader in net zero commitments when it committed in law in 2019 to achieve net zero greenhouse gas emissions by 2050, and it pushed this commitment further in 2021 by pledging to cut emissions by 78%, compared with 1990 levels, by 2035. There is high demand for sustainable investing to meet this goal, with 70% of the UK public wanting their money to go towards making a positive difference to people or the planet. Despite significant increases in sustainable financing volumes over the last five years, levels of investment fall short of what is required to meet the UK's net zero commitment, with some experts estimating that an increase in sustainable investment of approximately 450% on 2021 levels is required.

Although the explosion in sustainable finance in recent years evidences strong market and investor support for decarbonising the global economy, the transition has not been without its challenges. The rapid increase in both supply of and demand for sustainable investment products has, at times, resulted in a lack of consistency, transparency and reliability of disclosures and metrics. It was a focus of discussion and debate at the 27th Conference of the Parties ("COP27") to the United Nations Framework Convention on Climate Change ("UNFCCC"), which took place in Sharm el-Sheik, Egypt on 6-20 –November 2022. Although the role of private finance continued to be a focus at COP27 (as it was at COP26 in Glasgow in 2021), delegates acknowledged the continued lack of clarity on government policies, incentives and commitments along with the intended pathways to achieve them, which has limited the ability of financial market participants to distribute capital efficiently.

The UK Government has acknowledged the need for clear and consistent sustainable finance regulations and has implemented a number of initiatives to highlight the importance of the financial markets in supporting the transition to a low-carbon economy and to encourage increased investment towards net zero. In 2019, the Government published the Green Finance Strategy, which sets out two key lines of effort in the drive to align UK financial flows with a low-carbon world: "greening finance", or supporting the financial services sector to align with the UK's net zero commitment and wider environmental goals, and "financing green", or mobilising private finance at scale to support clean and resilient growth. The Government is now seeking to build on these foundations with a three-phase approach to delivering on the Green Finance Strategy, with the initial focus on addressing the information gap for market participants and ensuring that investors are provided with consistent, meaningful and comparable data regarding environmental sustainability. Central to these efforts will be the implementation of Sustainability Disclosure Requirements ("SDRs") across the economy and the ongoing development of a UK Green Taxonomy to ensure consistency across sustainability reporting.

SDRs

In November 2020, the Chancellor of the Exchequer announced that the UK intends to make disclosures aligned with the recommendations of the Task Force on Climate-Related Financial Disclosures ("TCFD") fully mandatory by 2025. To build on this implementation, new SDRs were announced in 2021 covering three types of disclosures: corporate disclosure; asset manager and asset owner disclosure; and investment product disclosure. The SDRs focus on requiring corporations, asset managers/owners and developers of investment products to substantiate their ESG claims in a way that facilitates comparison with other products and is accessible to clients and consumers. It also requires them to disclose whether and how they take ESG-related matters into account in their governance arrangements, investment policies and strategies. As of 1 January 2023, requirements are in place for disclosures aligned with TCFD requirements for all premium-listed and standard-listed issuers and for firms with more than £5 billion in assets under management or administration.

UK Green Taxonomy

The UK Green Taxonomy is being developed to combat greenwashing and provide more consistent and comparable information to support investor decisions. The Taxonomy will set out the criteria that specific economic activities must meet to be considered environmentally sustainable. Reporting against the Taxonomy will also form part of the SDRs. The Taxonomy proposes six environmental objectives, each of which will be underpinned by a detailed set of standards known as technical screening criteria: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. To be considered Taxonomy-aligned, an economic activity will have to make a substantial contribution to one of the six environmental objectives; do no significant harm to the other objectives; and meet a set of minimum safeguards. Among other objectives, the Taxonomy will allow for recognition of companies that, while not yet aligned to net zero, are engaged in transitional activities, or are investing capital expenditure in activities which are Taxonomy-aligned, or both. It will also recognise enabling activities, which support contributions to environmental objectives but are not yet sustainable themselves (such as the manufacture of wind turbines). The UK Government currently expects consultation on all six environmental objectives under the Taxonomy to be completed during Q1 2023.

Key Market Challenges

Sustainable finance still represents a very small proportion of overall UK financial markets activity, and companies in heavy carbon industries such as fossil fuels, while participating in sustainable finance activities, are not using raised funds to invest in their transition. While debt markets are becoming greener, equity markets have been much slower to transition, and greenwashing remains a significant concern. Finally, there is a wide gap between expectations and reality, as no amount of green financing will solve the problem of climate change, unless both the public and the private sectors are clear about how to meet their public commitments to reduce their climate impact and reach global net zero.

Sustainable or green financing was an area of focus at COP27, as even the billions committed thus far to the fight against climate change are far below the levels of investment required to implement the Paris Agreement. Efforts to increase investment include proposals to reform public lenders, such as the World Bank, by allowing them to take on more risk and lend more money, in the hope that this encourages increased participation by private investors.

The funding gap is particularly evident with respect to developing countries, which suffer disproportionate impacts from climate change and which are seeing a resulting increase in their debt burden. As an initial step in addressing this shortfall, COP27 concluded with a decision to establish and operationalise a loss and damage fund, which aims to compensate vulnerable nations for loss and damage resulting from climate-induced disasters. However, an agreement on how the fund should be financed, or by whom, is yet to be decided.

A key takeaway following COP27 is the need for continued collaboration between the public and private sectors. Private financing has gone a long way towards addressing the climate funding gap, but it cannot be a substitute for public policy. As governments and public bodies continue to clarify their goals and the paths to achieve them, the financial markets will respond and the risks and opportunities of sustainable finance will become clearer.

10 Top Key Takeaways

1. A key part of determining the path to net zero will be to ensure that it is an equitable transition that leaves no one behind, which will require significant financial investment, regulation and key policy drivers.
2. The roll out of SDRs across the economy and the ongoing development of a UK Green Taxonomy is essential to the UK Governments Green Finance Strategy. Asset managers should continue to clarify fund classifications under the market disclosure regulations.
3. As of 1 January 2023, requirements are in place for disclosures aligned with TCFD requirements for all premium-listed and standard-listed issuers and for firms with more than £5 billion in assets under management or administration.
4. For investors, reporting against the TCFD framework is an opportunity to critically assess the resilience of an organisation, including managing and measuring the risks, impacts and opportunities.
5. With mandatory climate risk disclosure requirements and increasing expectations on companies and their Boards to commit to sustainability targets, there is likely to be an increase in climate related litigation and the number of claims regarding 'greenwashing', as well as increased pressure for regulation to address these issues.
6. Investors will also look to diversify their portfolios against the risks posed by climate change, preferring a mix of funds, shares and asset classes.
7. As the need for energy efficiency and security becomes more prevalent, it will open up significant business investment opportunities. Fund managers will favour companies that invest in a range of innovative, sustainable solutions for their portfolios.
8. Private and public partnerships are required to work together to create solutions to climate challenges. This is pivotal to global development and to future economic activity.
9. Encouraging sustainable practices and contributing industry knowhow to de-risk early stage transition, will play a key role in closing the climate financing gap.
10. ESG risks can only be mitigated and ESG opportunities realised, when ESG is at the heart of all Board decision making.

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Private M&A in Luxembourg

An overview of the key features of the changes in rules

By Isabelle Lentz and Mina Turkkan

In July 2022, Luxembourg published a draft bill proposing a reform to amend the Luxembourg law of 10 August 1915 on commercial companies, as amended (the Company Law). The draft bill intends to implement into Luxembourg law the provisions of Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 (the Directive) amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (together, the Restructurings). The proposed reform aims to take the amendments a step further by updating the Company Law to modernise the legal framework on mergers and divisions, and by introducing a new regime on cross-border conversions.

The Directive outlines one of the overarching goals of the EU as the development of the internal market and sets harmonised rules for cross-border restructurings. The harmonisation of the domestic legal framework applicable to such transactions addresses the underlying issue of legal uncertainty, although it also introduces new – albeit manageable – legal challenges that the European M&A market will soon have to face.

A key policy behind the proposed reform is to further enhance the attractiveness of Luxembourg as a key jurisdiction for global M&A activity, by using all of the flexibility granted to Member States by the Directive to set up a regime that is as favourable to cross-border mobility as possible.

Its primary objective is, as far as possible, to limit the scope of the new complex rules to be introduced into Luxembourg law as a result of the Directive. In this respect, the new legal framework will include two separate regimes: (i) a general regime applicable to both domestic and cross-border restructurings; and (ii) a special regime that will govern only those European cross-border restructurings involving a Luxembourg limited liability company (other than a simplified joint-stock company (SAS)) namely, a public limited liability company (SA), a partnership limited by shares (SCA) and a private limited liability company (S.à r.l.) (the EU Cross-Border Restructurings). Furthermore, certain types of companies, such as undertakings for collective investment in transferable securities (UCITS), European companies (SE), mutual funds, and companies in liquidation where the distribution of assets has started, are excluded from the scope of the special regime.

This article:

- provides an overview of the key changes to the Luxembourg legal framework for domestic and cross-border restructurings that Luxembourg will soon be offering; and
- explores the impact of the proposed reform on the global M&A market in view of upcoming restructurings, as the new legal framework will apply only to those restructurings published from the first day of the month following the date of entry into force of the new bill.

What's new?

Regime applicable to domestic and cross-border restructurings

Domestic and cross-border restructurings – including a company from either a Member State or a non-EU country – will be covered by the same legal framework, which will undergo a series of amendments to simplify, to the extent possible, the rules that apply to such transactions to make them more efficient and cost-effective.

1. Opening-up of restructurings involving Luxembourg special limited partnerships

   Given their ongoing success under Luxembourg law, the Luxembourg legislator decided to allow special limited partnerships (SCSp) to be included in merger transactions without first being converted into a Luxembourg limited partnership (SCS) under the new regime. A Luxembourg SCSp cannot be involved in such transactions under the current regime as it has no legal personality of its own separate from that of its general

partner. This feature should further reinforce interest in this type of company and boost Luxembourg's attractiveness in the global market.

2. Simplified procedures and formalities with room for flexibility

Welcome progress can be achieved in terms of procedural flexibility as the new procedure outlined in the draft bill is a genuine opportunity for companies to establish certain rules to be followed for the relevant transaction to be valid, in particular:

- **Modification of the restructuring plan by the shareholders**

  Shareholders will have the right to make amendments to the restructuring plan provided that (i) the transaction is cross-border; (ii) it is allowed by the law governing each company involved therein; (iii) all the companies involved approve the restructuring plan in identical terms; and (iv) the relevant amendment has no impact on the situation of third parties, in particular employees and creditors.

- **Exemption from the independent expert report requirement for one-person companies**

  One-person companies will be exempt from the requirement to obtain an expert report issued by an independent expert. This exemption is in line with the Luxembourg legislator's intention to limit as many of the obstacles to mergers as possible.

- **Upstream and sidestream mergers**

  The proposed reform aims to simplify the procedure for upstream and sidestream mergers. Therefore, a merger by absorption carried out by a person who directly or indirectly holds all the shares of the merging companies will also include two simplified forms of merger: (i) upstream merger (whereby a company transfers the entirety of its assets and liabilities to its parent company via dissolution without liquidation); and (ii) sidestream merger (whereby a company transfers the entirety of its assets and liabilities to an existing company, via dissolution without liquidation and without the issue of new shares by such company, provided that the merger is carried out by a person that directly or indirectly holds all of the shares in the merging companies or the shareholders of the merging companies hold shares in the same proportion in all the merging companies).

3. Effective date of the merger

In the case of an EU cross-border merger, the date on which it takes effect will be determined by the law applicable to the company resulting from such merger. Where the cross-border merger involves a company from a non-EU country, the Luxembourg legislator decided for reasons of legal certainty that the effective date of the merger towards third parties will be the date of publication of the minutes of the general meeting of the acquiring company.

Regime applicable to EU cross-border restructurings

1. Flexible control of legality

The proposed reform aims to streamline the rules on the control of legality of cross-border mergers to be carried out by a notary. The objective is to consider divergences between the national laws of the various non-EU countries which are not subject to the harmonised regime set out in the Directive and to adapt the applicable Luxembourg legal framework to this particular circumstance. In this context, the Luxembourg legislator decided that the Luxembourg Trade and Companies Register will accept as evidence of the effectiveness of the merger not only a notification by the registry having jurisdiction over the acquiring company, but also a legal opinion issued by local counsel, such as a notary or law firm. This feature should improve efficiency, as well as promote mergers between Luxembourg companies and those from non-EU countries.

2. Disclosure requirements

In order to protect the shareholders, the proposed reform requires that certain preparatory documents be made available for review by the shareholders either electronically or at the registered office of the company, prior to the general meeting for the approval of the restructuring plan. These documents include, among others, (i) the restructuring plan; (ii) a report issued by the management body of the company; and (iii) a report issued by an independent expert. As this requirement is primarily in the interest of the shareholders, the shareholders will have the right to waive it, except for the restructuring plan, which will need to be published in the Luxembourg Trade and Companies Register at least one month before the date of the general meeting.

3. Protection of creditors

Creditors (i) whose claims arose prior to the publication of the common draft terms of the relevant EU cross-border merger (and such claims were not due at the date of such publication); and (ii) who are not satisfied with the safeguards offered in those common draft terms, will be entitled to bring an action before the court, after giving notice to the debtor company within three months of the publication thereof. The company will have the right to dismiss such claim by paying the creditor, even if the claim has expired. The filing of such claim will not have a suspensive effect on the transaction.

4. Protection of minority shareholders

The Luxembourg legislator intends to ensure that the minority shareholder protection mechanism does not go beyond the minimum necessary to provide adequate protection. In view of the intention to limit the right of withdrawal, the minority shareholder will be allowed to exercise their right of withdrawal only during the general meeting in relation to the approval of the common draft terms of merger and only by voting against the merger and expressing the wish to transfer their shares in exchange for compensation as set out in the common draft terms. The shareholder reserves the right to challenge the amount of such compensation before the court within one month following the relevant general meeting approving the transaction. The filing of such claim will not have a suspensive effect on the transaction.

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An easy way to list securities on the Luxembourg Stock Exchange

By Fabien Debroise and Katia Fettes

This is what you ought to know about some straightforward and less onerous options to list in Luxembourg.

Introduction

The Luxembourg Stock Exchange (LuxSE) offers several fairly easy and straightforward options for the listing of both debt and equity securities, which require minimal prospectus disclosure and which benefit from approval procedures that are *not usually time-consuming or onerous. The below article provides an overview of such options and also focuses on the ongoing reporting obligations that the various types of listings entail.*

FastLane Admission Procedure

Back in October 2022, the LuxSE decided to exempt the admission of certain types of securities to trading on the EuroMTF market (the Euro MTF) from the requirement to produce a prospectus. The exemption is part of the new “FastLane admission process”, which has proved to be of particular interest to issuers whose shares are already admitted to trading on a regulated market in the EU and who intend to list debt securities on a multilateral trading facility, such as the Euro MTF operated by the LuxSE.

Pursuant to the FastLane admission procedure, a mandatory prospectus approved by the LuxSE for Euro MTF listing purposes is not required by the LuxSE for the following types of securities:

- Non-equity securities and equity convertible bonds issued by issuers whose shares are admitted to trading on an EU-regulated market or equivalent;
- Non-equity securities issued or guaranteed by states (EU Member States excluded), their regional or local authorities;
- Non-equity securities issued or guaranteed by an EU Member State’s regional or local authority;
- Non-equity securities issued by a multilateral institution that is not an public international body and whose members include at least one OECD Member State;
- Securities issued by central banks; or
- Securities issued by associations with legal status or by non-profit-making bodies, recognised by a Member State or an OECD Member State, for the purpose of obtaining the means necessary to achieve their non-profit-making objectives.

Pursuant to the new chapter IV of part II of the LuxSE rules and regulations (the ROI) (Admission to trading with approval of a prospectus), in order to obtain admission to trading of these types of securities, it is currently sufficient to submit (i) an admission document containing the terms and conditions of the relevant securities (the Admission Document) and (ii) an application form, which must include public sources of information about the issuer and the securities (the Application Form). The Admission Document must be prepared in an electronic and searchable format, while the Application Form is standardised and can be found on the LuxSE website.[1]

Listing process

The prospectus submission procedure is very straightforward. The draft Admission Document must be submitted to the LuxSE at least three business days prior to the expected listing date, whereas the final version of the Admission Document needs to be submitted for publication on the date the admission to trading commences.

As mentioned above, the procedure is not a fully fledged approval process and therefore the Admission Document will not be formally approved by the LuxSE. The process for admission to trading is much faster than the usual prospectus review procedure for Euro MTF listing prospectuses. However, it must be noted that the LuxSE has the discretion to require the submission of any additional documents which it deems necessary for the examination of the request, depending on the particularities of the issuance and the financial position of the issuer or guarantor involved.

The new admission process is of particular interest to issuers whose shares are already admitted to trading on an EU-regulated market or a market considered to be equivalent. Such issuers may now list debt securities on the EuroMTF of the LuxSE without even having to present a short-form prospectus. Although, so far, no specific guidance has been published by the LuxSE, it should consider the regulated markets in the UK or Switzerland as being equivalent for the purposes of the admission of securities to the EuroMTF.

However, notwithstanding the above, issuers may still choose to submit an ordinary ROI prospectus for approval by the LuxSE on a voluntary basis.

The ROI already contains certain exemptions from the general requirement to publish a prospectus, such as for securities that are fungible with securities already admitted to trading on the Euro MTF or for shares substituted for shares of the same class already admitted to trading on the Euro MTF. The new FastLane admission procedure has been implemented to complement the existing system.

Ongoing disclosure obligations

It is however important to note that the exemption from the obligation to publish a prospectus within the context of the FastLane procedure does not affect the issuer’s disclosure obligations under the ROI following admission to trading, including the rules pursuant to Regulation (EU) No. 596/2014 on market abuse (MAR).

In this context, it is worth taking a closer look at the various types of disclosure obligations that issuers of securities admitted to trading on the Euro MTF must comply with, as these are often misunderstood.

Generally speaking, an Euro MTF-listed issuer of shares and debt securities needs to fulfil the obligations set out in both chapter 9 and 10 of the ROI.

1 www.bourse.lu/forms

Chapter 9 of the ROI

Chapter 9 of the ROI sets out a series of communication obligations which apply to listings of securities on markets operated by the LuxSE.

A communication obligation, in contrast to a publication obligation, is complied with when the issuer provides the information in question to the LuxSE by way of email to the following address: ost@bourse.lu. Such communication obligation does not entail any specific duty to inform the market as a whole and is therefore fulfilled by notifying the LuxSE.

Securities Events pursuant to items 903 and 904 of the ROI

Pursuant to items 903 and 904 of the ROI, the issuer must communicate as early as possible to the LuxSE any information relating to events affecting the securities that the LuxSE deems necessary to facilitate the due and proper operation of the market. Such information must be communicated to the LuxSE in advance of the listing of the securities or corporate event so that the LuxSE can take appropriate technical measures. Item 904 contains a non-exhaustive list of securities events which trigger a communication obligation.

For instance, among other events, any amendments affecting the respective rights of the various categories of shares, depositary receipts, equity linked securities or debt securities must be communicated to the LuxSE, as well as any business combination or split of the issuer or any change of the name of the issuer.

Likewise, the issuer must also provide to the LuxSE specific information in respect of the payments under the securities admitted to trading, such as the announcement of any distribution, the payment and detachment of dividends or interest as well as any redemption of debt securities, in particular before the due date.

The same applies to payment default scenarios and in a more general manner to any decision relating to any bankruptcy, insolvency or cessation of payments. As regards the advent of price-sensitive information, it is important to note that such price-sensitive information (in addition to any further obligations pursuant to the MAR) also constitutes a securities event and therefore triggers a communication obligation pursuant to items 903 and 904 of the ROI.

Disclosure of information pursuant to items 906 and 907 of the ROI

Furthermore, an issuer whose securities have been admitted to trading on either the regulated market or the Euro MTF must communicate to the LuxSE, at the latest at the requisite moment for making public and filing, all information concerning those securities which the issuer is required to make public under both Luxembourg and European Union law. In other words, the LuxSE requires its issuers to provide it with any information the issuer in question is required to publish according to rules and regulations other than the ROI.

In this context, item 907 of the ROI provides a non-exhaustive list of information which triggers a communication obligation. For instance, all regulated information which the issuer must file with the competent transparency supervisory authority (determined according to the definition of home Member State in article 2(1)(i) of Directive 2004/109/EC (the Transparency Directive)) must be communicated to the LuxSE.

However, such communication obligation does not arise in relation to regulated information the issuer must publish according to the Luxembourg law of 11 January 2008 on transparency requirements of issuers whose securities have been admitted to trading on a regulated market, as amended (the Luxembourg Transparency Law) and which it has stored with the *officially appointed mechanism* operated by the LuxSE (OAM).

In other words, issuers whose securities have been admitted to trading on the regulated market of the LuxSE and whose competent transparency supervisory authority is the CSSF pursuant to the Luxembourg Transparency Law will not need to communicate such regulated information to the LuxSE. The fact that it stores such information with the OAM is sufficient.

Furthermore, an issuer whose securities have been admitted to trading on either the regulated market or the Euro MTF must communicate important changes or any modifications to its articles of association to the LuxSE.

Likewise, notices for meetings of security holders must be communicated to the CSSF.

Chapter 10 of the ROI

Chapter 10 of the ROI contains a number of publication obligations applicable to issuers of shares and/or debt securities which have been admitted to trading on the Euro MTF. This chapter relates only to admissions to trading on the Euro MTF. The reason for this is that issuers whose securities have been admitted on the LuxSE Regulated Market have to comply with the publication obligations arising from the application of the Transparency Directive. However, since issuers of securities listed on the Euro MTF do not need to comply with the Transparency Directive's publication obligations, a separate framework of publication obligations for the Euro MTF was established.

Publication of ongoing/annual financial information

As far as the publication of ongoing financial information is concerned, every issuer of debt securities admitted to trading on the Euro MTF must publish as soon as possible its latest annual accounts and its latest management report. In contrast to equity issuers on the Euro MTF, there is no general obligation to publish half-yearly financial reports.

However, in a lot of instances, issuers of debt securities admitted to trading on the Euro MTF will be exempt from the publication of such annual financial reports. This is the case in three separate scenarios:

- where the bonds in question have a denomination per unit equal to or above €100,000;
- where the bonds are admitted to trading on the Professional Segment of the Euro MTF operated by the LuxSE; or
- where publication is not mandatory under the issuer's national law.

The third exemption scenario is usually applicable to issuers who do not have to provide such annual financial report in their country of incorporation. In such case, the LuxSE takes the view that such issuers should not be required to publish such a report only for the purposes of the Euro MTF listing. However, if the issuer in question has made and published/filed such a report on a voluntary basis, the LuxSE would normally expect such issuer not to resort to the exemption under the ROI, but to publish it.

The abovementioned exemptions can be relied upon only if the issuer in question has only those securities admitted to trading on the Euro MTF which fulfil the criteria mentioned above (ie the per unit minimum denomination or the Professional Segment listing). For example, the exemption cannot be used if any other Euro MTF listing exists in relation to securities which have a per unit minimum denomination of less than €100,000, or the equivalent amount in any other currency.

Publication of ad hoc information

Furthermore, a Euro MTF-listed issuer of debt securities must also publish any changes to the rights of the relevant debt securities' holders which would result in a change to the terms and conditions of the debt securities. Here, the LuxSE takes the view that such publication must clearly show all modifications to the terms and conditions. Therefore, we strongly recommend that you publish a redline/compare version.

Means of publication pursuant to item 1004 of the ROI

The information to be published pursuant to items 1003 and 1004 of the ROI must be made public through media reliable for the effective dissemination of information to the public in Luxembourg. This requirement is met if, for instance, the information is published by way of a press release posted on LuxSE's website (www.bourse.lu). The LuxSE offers a specific news service which can be used for this purpose.[2]

SOL inscriptions

For issuers looking to gain visibility who do not require full admission to trading, the LuxSE offers the possibility to obtain a listing without admission to trading by admission to its Securities Official List (SOL).

Admission to the SOL involves a registration of the securities on that list. However, it does not include admission to trading of such securities on the LuxSE. The approval of a prospectus compliant with the ROI is not required for admission to the SOL and the applicable disclosure regime is significantly lighter. The issuer only needs to provide an information notice including minimum details about the securities and the issuer.

Neither the Transparency Directive nor the MAR applies to such SOL listings.

2 FNS (financial news service) operated by the LuxSE: www.bourse.lu/fns

Professional Segments

As is the case with other stock exchanges in the EEA, the LuxSE offers issuers who exclusively target wholesale market participants such as professional investors/qualified investors two restricted trading segments to which only such investors have access (each, a Professional Segment).

The admission to trading on a Professional Segment, in contrast to a conventional admission to trading on the regulated market or the Euro MTF market of the LuxSE, offers some "alleviations" for the issuer.

It is therefore worth taking a closer look at the three main legal frameworks which usually apply in the context of a listing on the LuxSE before discussing the advantages of a Professional Segment listing in more detail.

These three legal frameworks are Regulation (EU) No. 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the Prospectus Regulation) together with Commission Delegated Regulation 2019/980 as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No. 809/2004 (the Prospectus Content Regulation), the Luxembourg Transparency Law and the ROI.

General characteristics of the Professional Segment

Securities which have been admitted to trading on these restricted trading segments will not be accessible to retail investors as trading on the Professional Segments is allowed only among professional investors.

The relevant application files must clearly indicate the Professional Segment chosen by the issuer. Trading members of the LuxSE placing transactions in such securities for their clients are not allowed to accept orders involving instruments traded on any of the Professional Segments that do not come from professional clients or qualified investors / well-informed investors as defined in the ROI.

Listings on the Professional Segment in the context of the Prospectus Regulation and the Prospectus Content Regulation

Recital 21 of the Prospectus Regulation refers to the introduction of an alleviated system with respect to listings on trading segments designed for and restricted to professional/qualified investors. This system however relates only to non-equity securities and does not cover any issuances of equity securities.

As regards the content of a prospectus for the purposes of an admission to trading on the regulated market operated by the LuxSE, less onerous information requirements apply to securities listed on the Professional Segment than those applicable to non-equity securities offered to retail investors. Pursuant to article 8(2) of the Prospectus Content Regulation, Annex 7 can be applied, which contains less stringent information items. This is interesting for issuers who prefer not to issue debt securities with a per unit minimum denomination of €100,000 as both cases (ie the issuance of such per unit minimum denomination notes and the intended admission to trading on a restricted professional investors trading segment) enable the issuer to use Annex 7.

Furthermore, there is no requirement to include a summary in the prospectus or to provide a separate summary note pursuant to article 7(1)(a) of the Prospectus Regulation for such listings.

Post-listing disclosure obligations under the Luxembourg Transparency Law

However, the alleviated prospectus system does not have any specific impact on the issuer's ongoing disclosure obligations under the Luxembourg Transparency Law.

In fact, there is no exemption mechanism or particular provision which would lead to the application of less onerous post-listing disclosure rules. Specifically, this means that only issuers who have obtained the admission to trading of debt securities which have a per unit minimum denomination of €100,000, or any other equivalent amount in another currency, can resort to the exemption from publishing their annual financial and half-yearly financial reports pursuant to article 7(1)(b) of the Luxembourg Transparency Law.

In other words, in contrast to the Prospectus Regulation and the Prospectus Content Regulation, the Luxembourg Transparency Law differentiates between such per unit minimum denomination wholesale issuances and listings on a Professional Segment by denying the latter any exemption from the issuer's periodic disclosure obligations.

From a practical perspective, this means that there should indeed be little incentive for issuers who have so far exclusively obtained regulated market listings of wholesale securities to start to admit retail-denominated securities on the professional segment of the LuxSE's regulated market since, by so doing, such issuers would have to comply with the periodic disclosure obligations set out in the Luxembourg Transparency Law going forward.

In the light of the discrepancy between the regimes of the Prospectus Regulation/Prospectus Content Regulation on the one hand and the Luxembourg Transparency Law on the other hand, the possibility that this issue will be addressed by a future review and amendments to the Transparency Directive cannot be ruled out.

Professional Segment listings under the framework of the ROI

Interestingly, the position under the ROI can be described as being the opposite of the one discussed above.

The reason for this is the fact that in terms of ongoing disclosure the ROI does provide an exemption mechanism for a Professional Segment listing on the Euro MTF market.[3]

Pursuant to item 1003(ii) of the ROI, an issuer of debt securities which have been admitted to trading on the Euro MTF is exempt from publishing its latest annual accounts and latest management report under specific circumstances. As has always been the case and in line with the system under the Luxembourg Transparency Law, an issuer of debt securities with a per unit minimum denomination €100,000 can resort to this exemption and thus does not need to publish annual financial accounts.

The fact that issuers of debt securities, unlike issuers of shares, are not required to publish a half-yearly financial report means that such an issuer will not have to publish any periodic financial information with respect to those securities.

However, the January 2020 revision of the ROI extended the scope of this exemption by adding a reference to "bonds being admitted to trading on the Professional Segment". This means that, under item 1003(ii), issuers of debt securities which have a per unit denomination of less than €100,000 and which have been admitted to trading on the Professional Segment of the Euro MTF can now also benefit from this exemption.

However, in terms of prospectus content requirements under the ROI, the position is different. The ROI does not provide any specific appendix containing alleviated information items for a Professional Segment listing prospectus. This means that the usual appendices for the issuance of debt securities, Appendices I and II for ordinary corporate issuers, are applied.

Summary

Using the FastLane admission procedure is a valuable alternative for issuers of equity securities which have already been admitted to trading on an EU-regulated market. Such issuers, if they intend to list debt securities on the Euro MTF, can now achieve such listing without having a fully fledged ROI prospectus approved by the LuxSE.

However, listings obtained using FastLane do not provide any alleviated post-listing reporting obligations. The usual ROI system containing both communication and publication obligations applies.

SOL inscriptions are an alternative for issuers who do not require full admission to trading. Such listings can be obtained by providing a modicum of information with respect to the listing document and are not subject to extensive reporting under EEA transparency rules, the ROI or the MAR.

Listings on the Professional Segment of either the regulated market or the Euro MTF market operated by the LuxSE might be an alternative for issuers who seek to target only professional/qualified investors but who do not wish to exclusively issue debt securities with a minimum per unit denomination of €100,000.

A Professional Segment listing on the regulated market of the LuxSE requires only a prospectus which complies with the alleviated disclosure regime of the Prospectus Regulation and the Prospectus Content Regulation. However, there are no specific exemptions from the post-listing periodic information disclosure regime under the Luxembourg Transparency Law. In fact, the exemption from publishing an annual and half-yearly financial report can be resorted to only if the issuer has exclusively issued and admitted to trading debt securities with a per unit minimum denomination of €100,000.[4]

As regards a Professional Segment listing on the Euro MTF market, the issuer is exempt from publishing annual financial reports irrespective of the per unit denomination of the securities. However, the usual appendices under the ROI apply for listings of debt securities issued by an ordinary corporate issuer.

3 Please refer to the section "Publication of ongoing/annual financial information" above.

4 Article 7(1)(b) of the Luxembourg Transparency Law.

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