Hogan Lovells

Doing business in the UK

The regulatory environment

2017

Contents

General background

This note describes in brief terms the regulatory environment which will apply to a foreign corporation undertaking business in the United Kingdom. It reflects the law as at 1 July 2017.

Following the EU referendum in the UK and the resulting Brexit vote there are likely to be significant changes to the regulatory environment however at the moment these changes are not clear or in place. We have a dedicated Brexit hub with a wealth of information about what may happen which can be found here: **http://hoganlovellsbrexit.com/brexit-toolkit**

Currently, businesses in the UK operate within an environment which encourages free competition. As a result:

– Price controls are not imposed (other than on certain regulated utilities)

– There are no exchange control restrictions on inward direct or indirect investment in, or on the repatriation of funds from, the UK by foreign individuals or corporations or on the repatriation of funds by dividend, loan repayment or any other means and

– In general, no restrictions are imposed on foreign ownership or investment.

Save for businesses operating in the financial services sector (see page 10) and the regulated utilities sector (see page 14), most businesses in the UK are only impacted by regulations relating to:

– Health and safety (of employees, consumers and the general public) and the environment

– Consumer protection and

– Certain technical standards (for example, to guarantee quality of products).

In addition, certain businesses will be impacted by rules designed to prevent money laundering and, if the business involves the collection and use of details relating to individuals, by rules protecting the use of personal data.

Finally, businesses operating in the UK will have to comply with EU and UK competition laws, which:

– Prohibit anti-competitive agreements between businesses

– Prohibit the abuse by a business of a dominant position in the market

– Regulate certain acquisitions, mergers and joint venture arrangements and

– Provide for regulatory intervention and sanctions in the event that competition laws are breached.

Further details about the rules and regulations described above are set out in the following pages of this note.

Money laundering

The Money Laundering Regulations 2017 require certain businesses to put in place various controls to prevent the business being used for money laundering by criminals and terrorists. These controls include appointing a "nominated officer", checking the identity of customers, keeping all relevant documents and reporting any suspicious activity to the National Crime Agency. The categories of business within the scope of the regulations include:

- Most UK financial and credit businesses such as bureaux de change, cheque cashers or money transmitters
- Independent legal professionals
- Accountants, tax advisers, auditors and insolvency practitioners
- Estate agents
- Casinos
- 'High value dealers' (businesses that accept cash payments for goods worth €10,000 or more either in a single transaction or in instalments) and
- Trust or company service providers.

At an early stage, it is important to understand whether the business will be subject to the money laundering regulations in order that the appropriate steps can be taken to ensure compliance with the applicable regulations.

Data protection

If the business will process "personal data" the requirements of the Data Protection Act 1998 ("**DPA**") will be relevant where:

- The business is established in the UK and the data is processed in the context of that establishment; or
- The business is established outside the European Economic Area (the "**EEA**") but uses equipment in the UK for processing data otherwise than for the purposes of transit through the UK.

Information is "personal data" if it relates to an individual who can be identified from:

- Such data; or
- Such data, together with other information that is in the possession of, or likely to come into the possession of, the data controller.

Typical examples of personal data which a business might handle are customer or employee records.

If the business is processing personal data, it is likely that it will need to register with the UK Information Commissioner's Office. It will also need to comply with the requirements of the data protection principles set out in the DPA. The most significant of these requirements are:

- Individuals need to be provided with certain specified information about how their data will be processed when personal data is collected from them
- In certain cases, the business will need to obtain individuals' explicit consent to processing of their personal data, for example where the information is classified as "sensitive data", such as information relating to their health or ethnic origin
- Individuals have a right to be told what personal data a business is processing about them (generally referred to as a "subject access request")
- The business must have adequate security measures in place to protect personal data from unauthorised use or accidental loss
- If the business uses a third party to process personal data for it, it should have a written contract with that third party
- There are restrictions on transferring personal data to countries outside the EEA where the recipient country does not provide an "adequate" level of protection for personal data, unless the transfer falls within one of the exceptions identified in the DPA. It should be noted that the U.S. as a whole does not meet the "adequacy" requirement. Previously companies which belonged to the U.S.-run Safe Harbor were considered to do so, but the scheme was declared invalid in October 2015. A replacement, known as "Privacy Shield" has been in place since 1 August 2016. The Privacy Shield framework requires that companies comply with seven privacy principles. U.S. companies can self-certify by filing an online registration with the Department of Commerce at **www.privacyshield.gov**. Once approved EU entities will be able to lawfully transfer personal data to these U.S. companies and
- The DPA and the Privacy and Electronic Commerce Regulations also regulate marketing to individuals. Individuals have a right to opt out of any kind of marketing. Generally marketing by email or SMS requires prior opt-in consent. Use of cookies or similar technologies also requires consent.

A maximum penalty of £500,000 can be imposed for serious contraventions of the data protection principles.

From May 2018, the DPA will be replaced by the General Data Protection Regulation (the "Regulation"). The main principles applicable to data processing will remain the same but the Regulation will strengthen individuals rights in respect of their personal data and introduce a new principal of accountability, which will require companies to have policies and procedures in place to ensure that they comply with the Regulation. The Regulation will also introduce significantly higher fines, with some infringement being liable for up to 4% of global turnover of the undertaking. Companies will need to start planning for these changes now, as they are likely to have implications for internal systems. More information can be found on the Hogan Lovells GDPRnow app.

EU and UK competition rules

Businesses operating in the UK will have to comply with EU and UK laws prohibiting anti-competitive behaviour and regulating acquisitions, mergers and joint ventures.

Interaction between EU and UK competition law

Competition law in the UK is contained in the Competition Act 1998 which broadly follows the principles of EU competition law, as contained in Articles 101 and 102 of the Treaty on the Functioning of the European Union.

UK competition law applies where the effect on competition and trade is internal to the UK. EU competition law applies where there is an appreciable effect on competition and trade between EU Member States. The European Commission enforces EU competition law; the UK authorities (the Competition and Markets Authority ("**CMA**") and various sectoral regulators[1]), have jurisdiction to enforce both EU and UK competition law, as do the UK courts.

Anti-competitive agreements

Competition law prohibits agreements or concerted practices between businesses which have as their object or effect the prevention, restriction or distortion of competition. This includes price-fixing; controlling production or development; sharing markets or supply sources; imposing discriminatory conditions on trading parties; and arrangements that otherwise restrict competition as between competitors or in an upstream or downstream market.

An agreement which has positive economic effects may be exempt from the prohibition.[2] However, it is not possible to obtain a formal exemption decision from a competition authority. Instead, businesses must assess for themselves whether their arrangements meet the exemption criteria. There are also a number of "block exemptions" which exempt certain categories of agreements where specified criteria are satisfied.[3]

In practice, there are many grey areas, particularly in the application of the exemption criteria, which means that businesses may lack legal certainty as to whether or not the proposed activity breaches competition law.

In the UK, the Enterprise Act 2002 makes it a criminal offence for an individual to agree with another to engage in cartel activity (price-fixing, production or supply-fixing, market or customer-sharing or bid-rigging) in respect of a UK market. Directors of companies that are found to infringe competition law can also face disqualification from acting as a director.

Abuse of dominant position

Competition law further prohibits the abuse by a dominant business of its position of market strength. This is targeted at a business's unilateral conduct which may harm competition.[4]

A business is considered dominant if it is in a position of economic strength and has the power to behave independently of competitors and consumers. Market share plays a role in assessing dominance: as a rule of thumb, a consistent market share exceeding 50% is likely to be regarded as a strong indicator of dominance. However, other market characteristics are also relevant. Examples of typical abusive conduct include charging unfair prices; limiting production; foreclosing competitors through exclusive dealing or refusal to supply; discriminating against equivalent parties; and imposing unreasonable supplementary obligations. Dominant businesses thus have a special responsibility to ensure they do not harm competition.

1 These include: energy – regulated by Ofgem; communications – regulated by Ofcom; rail – regulated by the Office of Rail and Road; air traffic services – regulated by the Civil Aviation Authority; water – regulated by Ofwat; healthcare services in England – regulated by NHS Improvement (formerly Monitor); financial services – regulated by the Financial Conduct Authority; and payment systems – regulated by the Payment Systems Regulator.

2 To benefit from the exemption, the agreement must: (a) improve the production or distribution of goods or promote technical or economic progress; (b) give consumers a fair share of resulting benefit; (c) not impose unnecessary restrictions; and (d) not allow the business concerned to eliminate competition in relation to a substantial part of the products or services in question.

3 In the fields of IP, research and development, shipping, motor vehicles, insurance and vertical agreements.

4 It is also possible for two or more businesses to hold a collective dominant position where they present themselves or act together in a particular market as a collective entity.

Merger control

Under the EU merger control regime, where the businesses involved in a merger have substantial turnover[5], it may be necessary to make a notification to the European Commission. The merger cannot be completed until consent is given. If it has competition concerns, the European Commission can undertake a detailed investigation and ultimately block the merger or, more commonly, require divestments. If the EU merger control regime applies, it is not necessary to make a merger control notification in the UK or any other EU Member State.

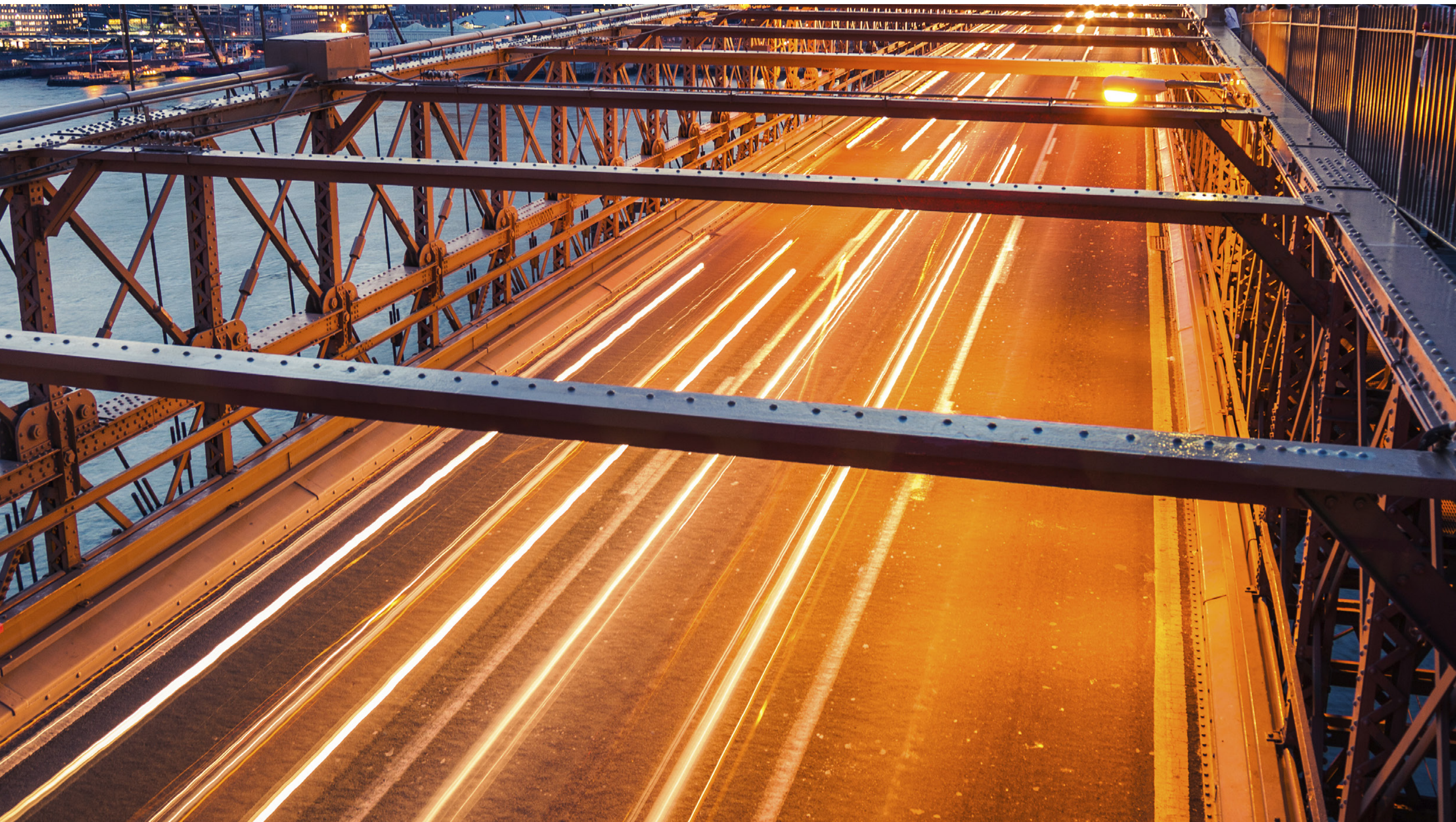
Where the EU merger control regime does not apply, under the UK Enterprise Act 2002, the CMA can investigate a merger situation where two or more enterprises cease to be distinct and either the target's UK turnover exceeds £70m or the enterprises will together supply 25% or more of a product or service in the UK. Notification is voluntary and so completion of the merger can take place before clearance is given. However, if the parties do not notify, the purchaser takes the risk that the transaction may be investigated, the implementation of the transaction is suspended during the period of investigation, and ultimately divestments are required or the transaction is unwound.

Variations on the normal UK merger control regime apply to transactions involving the water or media sectors, or impacting on national security or financial stability.

Procurement and State aid

Businesses may also need to consider or may be affected by EU procurement law (which requires a public authority or utility company to advertise substantial tenders on an EU-wide basis) and State aid law (which regulates the granting of aid by Member States).

5 Generally, where combined worldwide turnover of all the parties is more than €5bn and EU-wide turnover of each of at least two parties included in the merger is more than €250m the transaction will be caught by the EU merger control regime (but more specific criteria apply under Articles 1(2) and 1(3) of the EC Merger Regulation 139/2004).



Financial services

The UK has a stringent regulatory regime which applies to businesses operating in the UK financial services market.

There are a number of ways to enter the UK financial services market:

- Establish a new UK company
- Establish a UK branch of an existing overseas company
- Provide services into the UK from overseas without establishing a place of business in the UK or
- Acquire a company which already operates a financial services business in the UK.

In deciding whether to enter the UK financial services market, and which method of entry to use, the main issues to consider are:

- Will a new regulatory permission be required?
- Can a branch be established instead of incorporating a subsidiary company?
- The requirements for appropriately experienced key staff
- The amount of capital which must be injected into, or retained in, the UK
- Ongoing legal and regulatory compliance; and
- If acquiring a company, the approvals or other conditions which must be obtained or satisfied.

This note uses the term "company" for simplicity; but the principles apply equally to other types of legal entity; for example, partnerships and investment funds.

If joining or participating in insurance business is of interest, one way this can be done is through the Lloyd's of London insurance market. This note does not provide detail on the Lloyd's of London market and a separate guide to joining, and participating in, this market can be provided if required.

Will a new regulatory permission be required?

A significant number of financial services activities have been specified as "regulated activities" by UK legislation. A regulated activity may only be carried on by way of business in the UK[6] by:

- A company which has a regulatory permission for that activity from either the Prudential Regulation Authority (the "**PRA**") or the Financial Conduct Authority (the "**FCA**")
- In the case of certain regulated activities carried on through a UK branch or directly from overseas, a company which has regulatory permission to perform that activity from its home regulator in another member state of the EEA or
- A company which is exempt from the requirement to have a regulatory permission for that activity.

The key types of regulated activities include:

- Activities relating to banking business – in particular, the activity of accepting deposits
- Activities relating to insurance business
- Activities relating to the provision of credit, secured and unsecured, to consumers and small businesses
- Activities relating to investment business and
- Acting as a broker or other intermediary in relation to these types of business.[7]

The nature of the activity carried on by a firm determines who it will be authorised by. Banks, insurance companies and large investment firms are authorised by the PRA and all other financial services firms by the FCA. In addition, participants in certain "designated" payment systems are regulated by the Payment Systems Regulator.

6 The regulated activity must be carried on "by way of business" (which occasionally provides an exemption in the case of ancillary activities) and "in the UK" (which can capture some activities even where conducted from an office overseas but which can, in some cases, by careful structuring, make it possible to deal with UK clients without needing a UK regulatory permission).

7 Note that the regulation of intermediaries extends beyond the financial services sector – for example, it will apply to a travel agent arranging travel insurance for a customer.

The time and cost of obtaining a new regulatory permission depends on the nature, scale and complexity of the business concerned. After an application is received, the PRA or FCA may take up to six months to approve or reject it, and may "stop the clock" and request further information.

Can a branch be established instead of incorporating a subsidiary company?

Where an overseas company already operates in the financial services sector, it is likely to be better for the business if a branch of the existing company can be established in the UK. This is because it is easier to transfer resources within a single legal entity (between the branch, head office and any other branches) than would be possible between separate legal entities and, depending on where the existing company is located, this may avoid the need for a new UK regulatory permission.

An existing bank, insurance company, investment firm or insurance intermediary which is already authorised in the EEA may be able to establish a branch in the UK without needing a regulatory permission from the PRA or FCA. It may also be permitted to provide services directly into the UK without establishing a UK branch. In either case, the home regulator will be involved in the process which is likely to be faster and less expensive than obtaining regulatory permission from the UK regulator.

Banks, insurance companies, investment firms and insurance intermediaries with no existing presence in the EEA, and companies wishing to carry on other regulated activities in the UK must obtain a regulatory permission before commencing business in the UK. The permission can be granted to a UK branch of the existing company, although the PRA or FCA are likely to prefer that a new subsidiary is established.

Ongoing legal and regulatory compliance

Both the PRA and FCA have extensive rules. The FCA's conduct of business rules apply to all firms including those regulated by the PRA. These so called "dual regulated" firms must deal with both the PRA and FCA. The rules can be divided into a number of categories:

- **Prudential rules**: relate principally to regulatory capital and liquidity (see above)
- **Governance rules**: relate to the manner in which the company's business is managed and controlled, in particular by its senior management
- **Conduct of business rules**: set out the specific requirements for dealings with customers
- **Reporting rules**: require regular reporting to the FCA on the state of the business
- **Fees and levies rules**: provide obligations to pay fees to the PRA and FCA and levies to fund the Financial Services Compensation Scheme (which provides compensation to customers of UK financial services companies which become insolvent) and
- **Disciplinary rules**: set out the procedures for dealing with rule breaches and the consequences of such breaches.

In addition, the FCA has an objective and duty to promote competition in the markets for regulated activities, which it primarily discharges through undertaking market studies. It also has competition law powers in respect of the financial services sector, exercised "concurrently" alongside the Competition and Markets Authority. The PRA has a secondary objective to promote competition, subordinate to its general objective to promote the safety and soundness of the firms that it regulates.

The principal costs involved in complying with these rules (other than the prudential rules) will consist in the salaries of those employed as directors (including non-executive directors) and those employed to carry out compliance and reporting functions. Generally, businesses with the greatest numbers of customers have the highest compliance costs.

The manner in which the company is managed will be regularly monitored and assessed by the regulators. How firms are supervised will depend on the nature of their activities.

Requirement for appropriately experienced key staff

Where an application is made for a new regulatory permission, a significant part of the application will focus on the key individuals at the company. Senior managers at banks and large investment firms, insurance companies and reinsurers must be pre-approved by the regulators. Individuals who perform “controlled functions” at smaller firms that are authorised and regulated only by the FCA will also need to be pre-approved. Controlled functions include acting as the chief executive or as a director of the company, whether executive or non-executive. Both the PRA and FCA place considerable importance on the quality of the non-executive directors. Other controlled functions include apportionment and oversight, money laundering reporting and, for life insurers, the actuarial function.

It will also be necessary to comply with the other relevant regulator's rules. For example, all firms must organise and control their affairs responsibly and effectively, with adequate risk management systems, and to establish and maintain such systems and controls as are appropriate to the business. This requires a business to have appropriate staff in place for all aspects of the business.

Where it is not possible or efficient for a business to employ its own staff for a particular operation, it is possible to outsource that operation to a service provider. Any outsourcing must be monitored carefully.

The amount of capital which must be injected into, or retained in, the UK

This depends on the nature, scale and complexity of the business concerned. It also depends on the manner in which the business is carried on in the UK. A UK branch of a company which is regulated in another EEA state will not be subject to the PRA's regulation of capital, and will not have to hold capital in the UK.

UK regulated entities must, however, be adequately capitalised. There is a fixed minimum requirement and a variable requirement which depends on specified factors such as the value and risk weights of the assets held, or the amount of business written or the amount of expenses incurred. In some cases, these requirements are supplemented by a requirement to maintain liability insurance.

In addition to the fixed and variable capital requirements banks, investment firms and insurers are also subject to an individual capital requirement determined by reference to the Individual Capital Adequacy Assessment Process ("**ICAAP**" or "**ICA process**"). Under this process, the company must, at least annually, analyse all of the risks to which it is subject and determine the amount of capital that it needs to hold to ensure that there is no significant risk that it will become unable to pay its debts as they fall due. The determination is subject to review by the PRA, which may supplement it by "individual capital guidance" (or "**ICG**"). If the ICAAP or ICA process, as supplemented by the ICG, indicates that the company must hold more capital than the fixed or variable requirement, the greater amount must be held.

Capital can be raised in a number of forms. Under PRA rules, the different forms are divided into a number of tiers according to their relative loss absorbency, and lower tiers are subject to eligibility limits. Share capital (tier one) and subordinated debt (tier two) are the most common. Preference shares (as distinguished from ordinary shares) have been a very common way to raise capital, although they may no longer form part of tier one capital for banks and investment firms.

Where an application is made to establish a new financial services company in the UK, the UK regulators may require projections setting out the amount of capital that the business will have to hold over the first three years of operation and may require the company to hold a multiple (usually between 1 and 2) of that amount of capital from the point of authorisation.

Capital requirements apply not only at solo level, but also at group level. If the company has sufficient capital on a solo basis, but there are capital deficiencies elsewhere in its group, even outside the EEA, this may lead to regulatory action being taken against the company itself.

In addition to capital requirements, the PRA and EU legislation impose liquidity requirements on banks and investment firms; this requires the retention of a buffer of high quality liquid assets.

Approvals or other conditions which must be obtained or satisfied when acquiring a UK financial services company

The acquisition of an existing UK financial services company will normally constitute an acquisition of "control" of a UK authorised person, for which the approval of the PRA or FCA is required. The regulator has 60 working days from the date of notification to respond, though it can "stop the clock" for up to 30 working days to request further information about the acquirer and/or its group. The regulator can also impose conditions on its approval if there are aspects of the acquisition about which it is uncertain.

In deciding whether to approve the acquisition, the regulator will assess whether the acquirer is "suitable" and whether the acquisition is financially sound in order to ensure the sound and prudent management of the company in the future.

Regulated sectors

In most sectors, the combination of technical regulation and competition law is sufficient to ensure that markets function effectively. In certain sectors, however, economic/price regulation is directly applied because of known factors that inhibit the effectiveness of competition.

The main sectors subject to economic/price regulation are:

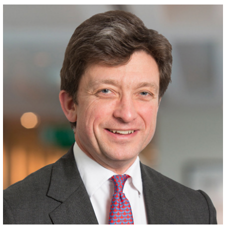
- Energy (gas and electricity) – regulated by the Office of Gas and Electricity Markets (Ofgem)
- Water and sewerage – regulated by the Water Services Regulation Authority (Ofwat)
- Communications (telecommunications, postal services, spectrum and broadcasting) – regulated by the Office of Communications (Ofcom)
- Financial services – regulated by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA)
- Payment systems – regulated by the Payment Systems Regulator (PSR)
- Healthcare services in England – regulated by NHS improvement (formerly Monitor)
- Civil aviation – regulated by the Civil Aviation Authority (CAA) and
- Railways – regulated by the Office of Rail and Road (ORR).

Specialist regulators have been established in these sectors and each regulator has responsibility for protecting consumers whilst ensuring competition can thrive. The precise role and powers of each specialist regulator differ, but generally the specialist regulators carry out a variety of functions, including: placing limits on price increases; imposing licence conditions on certain aspects of the business; monitoring and comparing the services the companies in that sector provide; exercising competition law powers; scrutinising the companies' costs and investments; and setting and achieving standards that must be met by companies providing services in that sector.

Further information

If you would like further information on any aspect of this note, please contact a person mentioned below or the person with whom you usually deal.

Contact



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