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Establishing an investment business in the UK

Part 1 - The overseas dimension

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Overseas investment businesses looking to set up in the UK have a number of options. The UK securities market is tightly regulated by the Financial Conduct Authority (**FCA**) and the Prudential Regulation Authority (**PRA**) but UK law gives overseas investment businesses three separate gateways for entering the market, one of which allows investment services to be provided across the rest of the European Economic Area (**EEA**).

Anyone carrying on *regulated activities* in the UK must either be authorised or exempt under the Financial Services and Markets Act 2000 (**Act**) or face criminal and civil penalties. A person is deemed to be carrying on *regulated activities* in the UK if he does so from a permanent place of business maintained by him in the UK.

Regulated activities are prescribed by Order [1] and in the context of investment business include activities such as dealing, arranging, managing, advising or providing custody services in relation to *specified investments* unless the activities fall within an exclusion. Investments are widely defined and include stocks, shares, units in collective investments schemes, derivatives, debt instruments, options and futures, and contracts for differences[2].

Businesses planning to provide investment services in the UK will need to choose one of the four options set out below. In determining which will best suit its requirements, an investment business will also need to take account of a number of other matters including taxation, exposure to process, employment of local personnel, directors' and officers' liability, and general compliance with UK law.

1. Establish an English incorporated entity

A newly established English incorporated entity would generally apply to the FCA[3] for permission/authorisation to carry on *regulated activities* in the UK in its own right. Depending on the exact nature of the activities to be undertaken, authorisation may provide an automatic "passport" under the European Markets in Financial Instruments Directive (**MiFID**) for the entity (referred to as an "investment firm" in MiFID) to branch or provide cross-border services into other EEA member countries without the need for separate authorisation in those countries.[4 5]

Where a branch of an authorised EEA entity is opened in another EEA state, the entity will be subject to the conduct of business rules of the EEA "host state" into which the firm branches; or, where the firm provides cross-border services into another EEA state without opening a branch, it will only be subject to its "home state" conduct of business rules, i.e., in the case of an English firm, those contained in the FCA's and, if applicable, the PRA's Handbook of Rules and Guidance. In either case, i.e., branch or cross-border services, the English firm will continue to be

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subject to financial and prudential regulation only by the FCA and, if applicable, the PRA as its "home state" regulators.

The main drawback of this route is that the entity must provide and maintain a prescribed level of capital, which, depending on the nature of the authorised business, could be substantial. As such, although this route provides the widest access to the marketplace, it is also the most regulated.

2. Establish an English branch (of a non-EEA incorporated entity)

An English branch of a non-EEA incorporated entity will require authorisation to carry on *regulated activities* in the UK because the entity will be maintaining a permanent place of business in the UK.

On becoming authorised in the UK, the overseas entity will be subject to the FCA's and, if applicable, the PRA's Handbook of Rules and Guidance, internal control and non-financial rules in relation to its branch activities. The result is that the entity avoids the need to tie up funds that would otherwise be required to meet UK capital rules. However, from a securities law perspective, the main drawback is that the branch cannot qualify for a MiFID passport and will not, therefore, be able to provide any investment services in, or branch into, other EEA countries without obtaining any necessary authorisation in each of the countries in which it wishes to do so.

3. Use the overseas person exclusion

An investment firm can engage in activities that would otherwise constitute *regulated activities* in the UK as an *overseas person* provided it does not do so, or offer to do so, from a permanent place of business maintained by it in the UK. To fall within this exclusion, very broadly, the firm must either restrict its activities in the UK to arranging deals with persons who are themselves authorised under the Act (or are exempted from the need for authorisation), or giving advice that does not result in an infringement of the UK *financial promotion* regime.

While this third option provides a useful means of gaining entry into the UK market (such as being able to conduct the occasional road show to UK fund managers and certain prospective investors, or to provide services to expatriate clients of the adviser who are residing in the UK), it only offers a limited gateway and does not avoid the need to comply with the *financial promotion* regime. It also carries the risk of creating potential criminal and civil liability if the activities undertaken fall outside the scope of the exclusion or any other applicable exclusions.

4. Operate outside the authorisation perimeter

It is possible that an investment firm setting up in the UK might do so through a branch or subsidiary without authorisation or reliance on the *overseas person* exclusion. If so, it is essential that it fully understands the limits of what it can do and restricts its activities to those which are either not covered by, or which fall within the terms of exclusions from, the *regulated activities* regime.

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Very broadly (but not exhaustively), the business could fall within the former category by restricting its activities to one or more of the following:

- generic or strategic advice concerning investment or markets;
- advice given to persons other than investors, e.g. issuers of securities;
- preparing business plans; and
- introducing clients to potential sources of funding without any further involvement.

To fall within the excluded categories the business must ensure that its activities are restricted to:

- investment services to other members of its group; and
- arranging transactions with or through persons who are authorised in the UK.

As with the *overseas persons* exclusion, operating to the strict limits of the *regulated activities* definitions, or within the confines of exclusions, carries the risk of criminal and civil liability if the activity extends beyond the scope of the limit or exclusion. In addition, the *financial promotion* regime will apply to all relevant communications made by the business. ■

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[1] The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended).

[2] See Part 2 for further details as to what constitutes a *regulated activity*.

[3] Certain entities wishing to provide, for example, banking or insurance services would apply to the PRA.

[4] MiFID is to be replaced in 2016/17 by revising legislation (**MiFID II**) and by the Markets in Financial Instruments Regulation (**MiFIR**). The MiFID "passport" will continue to be available to EEA entities under MiFID II/MiFIR but will, subject to certain caveats, be extended to non-EEA firms authorised in their home state who wish to carry out investment business in the EEA.

[5] Note that where an investment firm has also received from the FCA a full scope authorisation to carry out the regulated activity of managing or acting as a depository of an alternative investment fund (**AIF**) under the European Alternative Investment Fund Managers Directive (**AIFMD**) the firm would, subject to certain conditions being met, be entitled to an AIFMD "passport" under which it would be entitled to manage alternative investment funds in other EEA member countries on a cross-border basis or by establishing a branch.

Further information

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