UK - ENGLAND AND WALES

Investment rules of the world

DLA PIPER

About

At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.

UK - England and Wales

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both UK and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in the UK or to request that they are admitted to trading on a regulated market operating in the UK unless an approved prospectus has been made available to the public.

The International Capital Market Association has published standard form selling restrictions for offers of debt securities in the UK. These restrictions are aimed at preventing a breach of:

- the rules on financial promotion; and
- the rules on accepting deposits in the UK.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in the UK are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in the UK. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities, perpetual debt securities (ie debt securities that have no specified redemption date);
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- hybrid securities (securities with both debt and equity features);
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer);
- exchangeable bonds (debt securities convertible into the equity of a third party);
- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and

- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company).

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What are the differences between offering debt securities to institutional / professional or other investors?

On 25 June 2019, the Financial Services and Markets Act 2000 (Prospectus) Regulations 2019 (SI 2019/1043) were published. These Regulations make UK legislation compatible with the EU Prospectus Regulation (2017/1129) (Prospectus Regulation) and ensured that the Prospectus Regulation is effective and enforceable in the UK from 21 July 2019.

Under the Prospectus Regulation one of the circumstances in which a prospectus must be produced is where an offer of securities is made to the public within the European Union. An exemption from this requirement to publish a prospectus applies where offers are made solely to qualified investors (which are defined as persons or entities under the professional investor classification in the MiFID II Directive (2014/65/EU) (professional clients, persons treated as professional clients, and persons recognised as eligible counterparties)). However, if the debt securities are to be admitted to trading on an EU-regulated market a prospectus would still be required.

The nature of the information that has to be disclosed in a prospectus for the issue of debt securities under the Prospectus Regulation depends on whether the issue falls within the retail regime or the wholesale regime.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

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When is it necessary to prepare a prospectus?

Under the Prospectus Regulation (as implemented in the UK by Financial Services and Markets Act 2000 and the FCA's Prospectus Regulation Rules), securities shall only be offered to the public in the European Union after prior publication of a prospectus in accordance with the Prospectus Regulation. Securities shall only be admitted to trading on a regulated market situated or operating within the EU after prior publication of a prospectus in accordance with the Prospectus Regulation.

An offer would not be deemed to have been made to the public if, among other things, it is made solely to qualified investors, addressed to fewer than 150 persons (other than qualified investors) per member state or where the minimum denomination per unit is at least €100,000.

If the offer is deemed not to be made to the public, a Prospectus Regulation compliant prospectus may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having to publish a prospectus.

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What are the main exchanges available?

The London Stock Exchange has three principal markets on which debt securities are traded:

- the Main Market;
- the Professional Securities Market; and
- the International Securities Market.

The London Stock Exchange Main Market

The Main Market is a regulated market for the purposes of the Markets in Financial Instruments Directive (MiFiD), so issuers on the Main Market are subject to the requirements of a number of EU Directives, including the Market Abuse Directive and the Transparency Directive . Securities listed on the Main Market can be passported to other European Economic Area markets in order to access international investors.

The London Stock Exchange Professional Securities Market

The Professional Securities Market is an exchange-regulated market subject to the rules of the London Stock Exchange. It is not a regulated market for the purposes of MiFiD. It is therefore outside the requirements of the Prospectus regulation and provides a more flexible alternative to the requirements regarding denomination and financial information, compared to the rules which apply to regulated markets across Europe. As it permits reporting under national Generally Accepted Accounting Principles (GAAP), it offers an alternative for issuers not wishing to prepare financial information to International Financial Reporting Standards (IFRS).

The London Stock Exchange also operates the Order Book for Retail Bonds, which is an electronic trading platform for debt securities that are issued in denominations of less than £100,000 and listed on the Main Market.

The London Stock Exchange International Securities Market

The International Securities Market was launched in May 2017. It is an exchange-regulated market subject to the rules of the London Stock Exchange. Securities admitted to trading on the International Securities Market are not listed on the Official List maintained by the UK Financial Conduct Authority (FCA), so FCA approval is not required. Admission to trading and approval of the admission document is conducted by the London Stock Exchange only.

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Is there a private placement market?

The UK has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under English law. The UK has various investor protection statutory provisions relevant to liability for an inaccurate offering memorandum. There are also general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the trustee, which may be exercised without the consent of investors and without regard to the individual interests of particular investors. The conditions also provide for meetings of investors to consider matters affecting the investors interests. These provisions typically permit defined majorities to bind all investors including investors who did not attend and vote at the relevant meeting and investors who voted against the majority.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering fund securities and operating a fund, among other things, are regulated activities under the Financial Services and Markets Act 2000 and therefore subject to regulation by the UK Financial Conduct Authority.

Collective Investment Schemes

The regulations apply to activities undertaken in relation to 'Collective Investment Schemes' which are schemes comprising the following arrangements (subject to certain specific exceptions set out in the legislation):

- with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income;
- where the participants do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions; and
- that have either or both of the following characteristics:
  - pooling of investors' contributions and profits or income; and
  - the property is managed as a whole by or on behalf of the operator of the scheme.

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What are common fund structures?

Common forms of funds, some of which are further described in the UK Financial Conduct Authority Guidance on Collective Investment Schemes, include:

- open-ended (UK Authorized Unit Trusts (AUTs), Investment Companies with Variable Capital (ICVCs) and Authorized Contractual Scheme (ACSs)) and closed-ended funds;
- retail and non-retail funds (including Alternative Investment Funds (AIFs));
- Undertakings for Collective Investments in Transferrable Securities (UCITS) and non-UCITS funds; and
- qualified investor structures that invest in, for example, corporate shares or bonds, real property, commodities (for example, precious metals) and derivatives.

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What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Open-end retail funds must be either authorized by the UK Financial Conduct Authority (if UK domiciled) or recognized by the Financial Conduct Authority (if domiciled in another jurisdiction). Funds that are 'recognized' by the Financial Conduct Authority in this context mostly comprise Undertakings for Collective Investment in Transferable Securities (UCITS) funds established in other jurisdictions. Closed-end retail funds that are listed in the London Stock Exchange Main Market or specialist funds market are not 'authorized' by the Financial Conduct Authority, but the listing itself requires approval by the Financial Conduct Authority in its capacity as the UK listing authority.

Retail funds, including UCITS, are subject to substantial regulatory oversight and restrictions, including obligations with regard to independent custodian/depositary arrangements for assets, investment and borrowing powers specifications (for open-end retail funds), concentration requirements and other matters.

Institutional/professional funds

In practice, non-retail funds (other than limited partnerships) are usually established outside the UK because there are no UK non-retail tax-exempt fund vehicles (other than unauthorized unit trusts that are only offered to UK tax-exempt investors).

Closed-end funds are generally established as UK or offshore limited partnerships and open-end funds such as hedge funds are typically established as companies and unit trusts.

Non-retail funds that are offered in the UK generally fall into the category of Alternative Investment Funds (AIFs) and therefore subject to the Alternative Investment Fund Managers Directive regime in relation to authorization of the manager/fund, marketing arrangements, reporting, governance etc.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Separately managed accounts are also commonly used in the UK as an investment management structure – investor funds are generally held in a separate account subject to the discretionary investment authority of a manager who can acquire and dispose of assets using the investor funds in line with a pre-determined strategy and parameters set out in an Investment Management Agreement. These are often also structured as 'funds of one' in a separate vehicle.

Managing investments is a regulated activity under the UK Financial Conduct Authority rules and therefore subject to authorization; however managed accounts and 'funds of one' themselves are generally not classed as (and therefore avoid the regulatory restrictions in being classed as) Collective Investment Schemes or Alternative Investment Funds.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

UK selling restrictions

Generally, in the UK, offering securities is either covered under the UK Financial Conduct Authority's financial promotion regime, under the Undertakings for Collective Investment in Transferable Securities Directive regime or under the Alternative Investment Fund Managers Directive regime.

Undertakings for Collective Investments in Transferable Securities (UCITS)

UCITS, including those established in the UK, have a EU passport which enables fund promoters to create a single product for marketing in all EU member states and on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other.

A UCITS intending to market in another member state must complete and submit to its home regulator a notification including certain specified information, including copies of key investor documents. The home regulator then completes a notification file which is sent in a regulator-to-regulator transmission, following which the UCITS can be sold in the other member state.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Managers Directive, marketing is defined as: a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM may only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

Reverse solicitation and the definition of 'marketing'

Applicable in the context of professional investors, this is a sensitive area in the UK and Europe generally. The Alternative Investment Fund Managers Directive generally continues to permit professional investors who wish to invest in AIFs based on their own initiative (reverse solicitation); however, the EU is currently reviewing this area during 2017 and may impose tighter requirements.

Specifically in the UK, the Financial Conduct Authority has provided broad guidance on the definition of 'marketing' as follows:

- Marketing will, generally, not include secondary trading in the units of an AIF. Therefore, the listing of AIF units will not necessarily constitute marketing.
- The indirect offering or placement of units of an AIF will be considered as marketing (including the distribution through a chain of intermediaries or a placement agent).
- In certain circumstances, providing draft AIF documentation to potential investors will not constitute marketing.

The FCA also provides the following view specifically on reverse solicitation: confirmation from the investor that the offering or placement of units of shares of the AIF was made at its initiative, should normally be sufficient to demonstrate that this is the case, provided this is obtained before the offer or placement takes place.

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Are there any restrictions on managing a fund?

Fund management in the UK is regulated under the Financial Services and Markets Act 2000, various statutory instruments and the Financial Conduct Authority Rules. The Financial Conduct Authority is responsible for regulating funds, fund managers and those marketing funds and any legal or natural person is prohibited from carrying on regulated activities, such as fund management, without authorization.

Various restrictions arise on manager structuring/compensation and profit-sharing arrangements as a result of the regulations and any manager that is subject to the remuneration rules must apply those rules proportionate to its size, internal organization and scope and complexity of its activities. The rules impact on, among other things, reporting, equity remuneration, deferred compensation arrangements and clawback.

Alternative Investment Fund Managers (AIFMs) are also subject to regulation under the Alternative Investment Fund Managers Directive (as implemented in the UK) and managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to certain requirements under the Undertakings for Collective Investment in Transferable Securities Directive. Full Financial Conduct Authority registration involves a significant authorization process – three-to-six months from completion of the application which must include:

- for the manager, information on senior personnel (must be suitable persons etc.), organizational structure, policies and procedures, remuneration practices; and
- for each fund, investment strategy, constitutional documents, depositary information and disclosure requirements.

However, AIFMs based in the UK can be exempted from full regulation on certain grounds, including managing assets under €500 million where assets are not leveraged and investors have no redemption rights for five years, and managing assets under €100 million including assets acquired through leverage. Exempted managers must still register with the regulator, are subject to limited reporting and it should be noted that they do not benefit from the general passporting for marketing purposes.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Unless an exemption or exclusion applies, a person entering into a derivatives contract by way of business in the UK (such as a dealer) will ordinarily have to be authorized under the Financial Services and Markets Act 2000 if the transaction is one of the specified activities set out in Part II of the Regulated Activities Order or the derivative constitutes a specified investment under Part III of the Regulated Activities Order such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

One of the key exclusions to the requirements above applies to persons who deal in derivatives for risk management purposes.

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What are common types of derivatives?

The UK accounts for about half of the $640 trillion over-the-counter market derivatives market.

Derivative contracts are entered into in the UK for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in the UK:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in the UK are:

- equity;
- fixed income instruments;
- commodities;
- interest rates;
- foreign currency; and
- credit events.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter (OTC) derivatives have attracted significant regulatory attention. The European Commission has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative position;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants.

The European Market Infrastructure Regulation (EMIR) formed part of the European regulatory response to the global financial crisis and sought to address the issues highlighted above. For example, EMIR requires:

- all transactions to be reported to regulators;
- some more standardised OTC transactions between certain categories of counterparties to be cleared with a central counterparty (i.e. a third party intermediary in the trade); and
- for those transactions not subject to mandatory clearing, certain other risk mitigation techniques to be applied including the posting and collection of initial margin and/or variation margin.

EMIR was amended by the EMIR Refit Regulation in June 2019 with the primary aim of simplifying certain requirements and reducing compliance costs for smaller counterparties. For example, under the EMIR Refit Regulation those categorised as 'small non-financial counterparties' do not need to comply with reporting and clearing requirements from specified dates.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is only a regulated activity in relation to mortgages and consumer lending. In these circumstances, and assuming none of the available exemptions apply, a lender will need to be authorized by the UK Financial Conduct Authority to conduct such business.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to unregulated loans. For example, for regulated mortgage contracts, there are particular restrictions around how:

- the loans are marketed, originated and sold;
- lenders administer the loans on an ongoing basis; and
- borrowers who fall behind with their payments are dealt with.

Regulated credit agreements on the other hand have specific requirements around how the agreement is drafted and formatted and what information must be included.

There are no additional restrictions that apply to foreign lenders making loans to UK borrowers.

Borrowing

While borrowers are generally not regulated, it is advisable for borrowers to consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

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What are common lending structures?

Lending in the UK can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working capital loans, equity bridge facilities, project facilities and letter of credit facilities etc.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending in the context of mortgages and to consumers is a regulated activity and so requires UK Financial Conduct Authority authorization. For more information, see Lending and borrowing – restrictions.

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Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of English law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

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Are there any other notable risks or issues around lending?

Generally

Loan agreements and other finance documents are subject to general contractual principles. For example, the England & Wales courts will not enforce a penalty and so lenders have to be careful about the rate of default interest charged on a loan. Lenders therefore tend to opt for a modest uplift of around 2% above the usual rate.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed UK mortgage regime. The Mortgage Credit Directive, implemented in the UK through a series of primary and secondary legislation, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second charge mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

Standard form documentation

Most English law syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

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Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write-down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

Market participants should also be aware of the on-going reform of the London Interbank Offered Rate (LIBOR) and other key interest rate benchmarks. LIBOR and other reference rates are commonly used in the calculation of interest and other payments under loans as well as various other financial products. Following the United Kingdom Financial Conduct Authority's announcement in 2017 of its intention to stop compelling banks to submit rates required to calculate LIBOR after the end of 2021, the loan market, like other financial markets, has been in a period of transition to alternative reference rates which can be used in loan and other financial contracts going forward. The expectation is that market participants, in many cases, will transition to 'risk free rates' (RFRs), which are mostly backward-looking overnight rates, supplemented by a spread adjustment to account for the different bases upon which LIBOR and other existing reference rates are calculated compared to the proposed RFRs. One of the key challenge for the loan market remains how to adjust the position in existing finance documents.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a company giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Under English law, directors have a general duty to promote the success of the company for the benefit of its members as whole; as such, they will need to be able to show that adequate corporate benefit is derived from the company giving the guarantee or security. This is often more difficult in the case of upstream or cross-stream guarantees or security provided by a subsidiary to its parent or sister company. The safe approach is often to have the members of the company approve the giving of the guarantee or security by resolution.

Insolvency

Guarantees and security may be at risk of being set aside under England & Wales insolvency laws if the guarantee or security was granted by a company within a certain period of time prior to the onset of insolvency. This would be the case if the company giving the guarantee or security received considerably less consideration, and as such, the transaction was at an undervalue. For such a transaction to be set aside, certain statutory criteria would have to be met, including that the guarantee or security was given within six months (or two years for connected parties) of the onset of insolvency of the affected party. Guarantees and security may also be challenged on other grounds relating to insolvency.

Financial assistance

It is unlawful for a public company to provide financial assistance for the purchase of its own (or of its holding company's) shares. The prohibition against financial assistance for private companies was abolished on 1 October 2008. Financial assistance in this context would include giving a guarantee or security in connection with the share purchase.

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What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms.

A particular distinction worth remembering is between a performance guarantee and a payment guarantee:

- A performance guarantee is a term used to describe both performance bonds (in the context of trade finance) and 'see to it' guarantees (in other contexts):
  - A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.
  - A 'see to it' guarantee is a promise by the guarantor to see to it that the primary obligor fulfils its obligations under the primary contract. If the primary obligor fails to fulfil its obligations under the primary contract, the guarantor will be in breach of its obligations under the guarantee.
- A payment guarantee is narrower in scope than a performance guarantee as it only covers the payment of money rather than other contractual obligations.

Common forms of security

There are three basic types of security interest that can be created under English law:

- a pledge;
- a charge; and
- a mortgage.

Different types of security are suitable for securing different types of assets.

Under English law it is possible to grant security over all of the assets of an English company or individual assets. Granting security over all of a company's assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real estate;
- a fixed charge over assets which are identifiable and can be controlled by the creditors (such as equipment);
- a floating charge over fluctuating and less identifiable assets (such as stock); and
- an assignment by way of charge over receivables and contracts.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. As a result guarantees are often executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements under English law which need to be observed.

Additionally, there is a risk that a guarantee may be set aside if it was procured by undue influence by a borrower or lender. A party being provided with a guarantee should be alive to this issue and take steps to avoid claims of undue influence by, for example, requiring the guarantor to take separate legal advice.

Giving or taking security

A security document may need to be executed as a deed if it:

- contains a mortgage over land;
- confers a statutory power of sale and power to appoint a receiver; or
- contains a power of attorney.

Once granted, security needs to be properly perfected before it is valid against third parties. Perfection formalities can range from having the secured asset delivered to the security holder, registration of the security and notice being given to third parties. Most charges created by an English company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the charge will be void against the liquidator, administrator or any creditor of the company and the money secured by the charge becomes immediately payable.

There are no notarization requirements for security documents under English law.

Like guarantees, for a period after a new security interest has been granted (known as the hardening period), it is at risk of being set aside in certain circumstances under insolvency laws. Reviewable transactions include those conducted at an undervalue, preferences and invalid floating charges.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Bank of England and Financial Services Act 2016
Financial Services Act 2012
Financial Services and Markets Act 2000
Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005
FCA Handbook and PRA Rulebook

Consumer credit

Consumer Credit Act 1974 (as amended)
FCA Handbook, Consumer Credit sourcebook

Mortgages

Mortgage Credit Directive (2014/17/EU) (mortgage credit)
Mortgages and Home Finance: Conduct of Business sourcebook

Corporations

Companies Act 2006
Overseas Companies Regulations 2009

Funds and platforms

Alternative Investment Fund Managers Directive (2011/61/EU) (fund managers)
Alternative Investment Fund Managers Regulations 2013 (fund managers)
Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) (mutual funds)

Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)
Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)
European Market Infrastructure Regulation (EMIR) (Regulation (EU) 648/2012) (derivatives)
EMIR Refit Regulation (Regulation (EU) 2019/834) (derivatives)
Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)
Markets in Financial Instruments Directive II (2014/65/EC) (financial instruments)
Markets in Financial Instruments regulation (600/2014) (financial instruments)
Payment Services regulations 2017 (payment service providers)
Electronic Money Regulations 2011 (electronic money issuers)

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Regulatory authorization

Who are the regulators?

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets, and also the prudential regulator for many firms. It is also responsible for enforcing the market abuse and listing regimes.

The Prudential Regulation Authority (PRA) is responsible for the prudential regulation of systemically important financial institutions, including banks, building societies, insurers and major investment firms.

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What are the authorization requirements and process?

Depending on the type of firm, a firm must apply to the Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) for authorization.

The regulators must assess whether the application meets the required threshold conditions within six months of the submission of the complete application.

The application fee depends on the type of the application ranging from £1,500 to £25,000.

The regulator will also approve key individuals (eg senior management) in their roles.

Authorized firms and individuals are listed on the FCA Register.

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What are the main ongoing compliance requirements?

Threshold conditions (such as having adequate financial resources and compliance arrangements in place) are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules can result in sanctions for firms and regulated individuals, and loss of regulated status.

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What are the penalties for failure to be authorized?

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment, fines and warnings. Contracts entered into with persons who are not authorized may not be enforceable and persons may be subject to compensation in various circumstances.

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Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition).

A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exclusions.

- Specified activities include activities such as accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.

- Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

Consumer credit

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are regulated activities.

Unless exempt agreements, these activities can only be offered by firms who are authorized and listed on the financial services register. The available exemptions relate to the nature of the agreement, the lender and the borrower, the number of repayments to be made and the total charge for credit. For example, credit agreements exceeding £25,000 that are entered into exclusively or predominantly for the purposes of the business of the borrower are exempt agreements.

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Are there any possible exemptions?

There are two types of exclusions available when regulated activities may be undertaken without authorization.

General exclusions

Certain persons may carry on a regulated activity without being authorized. For example, in certain cases regulated activities carried on by overseas persons may be undertaken without authorization.

Specific exclusions

For each type of regulated activity there are a number of specific exclusions that could also apply, such as making introductions (that is, making arrangements under which clients can, under certain circumstances, be introduced to another person, who is authorized).

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Do any exchange controls or other restrictions on payments apply?

The UK does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in and out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

Anti-money laundering and tax considerations may also need to be taken into account.

Payments services are regulated in the UK and must be undertaken by an authorised Payment Service Provider, such as a bank.

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What are the rules around financial promotions?

A financial promotion is a communication of an invitation or inducement to engage in investment activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless they are an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exclusions in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

It is a criminal offence for an unauthorized person to communicate a financial promotion.

Exclusions

Exclusions include certain promotions to certified high-net worth individuals or overseas recipients, provided certain criteria are fulfilled.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are limited companies and limited partnerships, both of which are body corporates with separate legal personality and limit the liability of their members.

Limited companies can either be private (denoted by the suffix Ltd or Limited) or public (denoted by the suffix PLC or Public Limited Company) depending on whether their shares are offered to the public. Some activities require a particular type of legal entity to be used. For example, offering debt securities to the public can only be done by UK Public Limited Companies.

The liability of a company's shareholders can be limited by shares, in which case they are liable to pay for their shares but not the company's debts, or by guarantee, where they are also liable to pay a certain amount if the company is wound up.

Limited partnerships (or LLPs) are similar to limited companies in many ways, with the main differences being that they are:

- formed by partners whose relationship is governed by private agreement rather than having shareholders and directors; and
- taxed like a partnership.

Funds

Investment funds tend to take the form of limited partnerships, limited companies (including open-ended investment companies (OEICs)), unit trusts (authorized and unauthorized), UK public companies (including those approved by HMRC as UK investment trusts) and authorized contractual schemes (ACS).

Fund managers on the other hand tend to be set up as limited companies (generally limited by shares), limited liability partnerships or limited partnerships.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A company can conduct lending or investment business in the UK through an establishment (also known as a 'branch') but this does not create a separate legal entity.

Overseas companies having a UK establishment (but which are not incorporated in the UK e.g. as a subsidiary entity) need to comply with the Overseas Companies Regulations 2009 which imposes registration, accounting, disclosure and other requirements. Such requirements do not apply to partnerships or other unincorporated entities with a similar UK presence.

Overseas companies carrying on a trade in the UK through a 'permanent establishment' will be subject to UK corporation tax.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure;
- applying technology to leverage and optimize the lending platform and user experience; and
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- consumer loans;
- student lending products;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P)-type structures, often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds, as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, the funding structure will often follow the format of a warehouse securitization structure. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure, the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt, this will typically result in the platform being treated as a securitization for the purposes of the European Union Securitization Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features, such as; its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the blocks using sophisticated algorithms and add the verified blocks to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another, or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of the transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO, as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;
- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform /personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms, which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The Financial Conduct Authority (FCA) is the conduct regulator for firms providing financial products and services in both retail and wholesale markets.

GENERAL

A person must not carry on a regulated activity in the UK unless authorized or exempt (known as the general prohibition). A financial activity requires regulatory authorization when it is identified as a specified activity in relation to a specified investment, it is carried on by way of business in the UK and it does not fall within any of the available exemptions. Where FinTech products and/or applications involve financial activity which requires regulatory authorization, the firms providing such products and/or applications must be authorized by the FCA.

PROJECT INNOVATE

In October 2014, the FCA launched an initiative known as Project Innovate with a view to encouraging innovation in the interest of consumers. Project Innovate has five initiatives:

- **regulatory sandbox** – providing businesses with access to the real market to test innovative products, services, business models and delivery mechanisms;
- **direct support** – providing a dedicated contact for innovator businesses that are considering an application for authorization or a variation to their permission;
- **advice unit** – providing regulatory feedback to firms developing automated models to deliver lower-cost advice and guidance to consumers;
- **reg tech** – encouraging technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively; and
- **engagement** – providing FCA engagement with a wide variety of businesses in the UK regions and internationally.

REGULATORY DEVELOPMENTS ON INVESTMENT PLATFORMS

In March 2019, the FCA published the final report of its Investment Platforms Market Study, in response to the increasingly important role of investment platforms in the retail distribution landscape. In December 2019, the FCA published final rules for platforms to make it easier for consumers to move from one platform to another without liquidating their assets. The new rules ensure that consumers moving onto a new platform are given the option to convert to discounted units, where these are available for them to invest in. These new rules come into force on 31 July 2020.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Since April 2014, a subsidiary of the FCA, the Payment Systems Regulator has regulated eight payment systems designated by HM Treasury, namely Bacs, Cheque & Credit, CHAPS, Faster Payment Scheme, LINK, Northern Ireland Cheque Clearing, MasterCard and Visa Europe. All participants in a designated payment system will fall under the remit of the Payment Systems Regulator, including operators that manage or operate the systems, the payment service providers using the system and the infrastructure providers to the payment system.

There are an increasing number of FinTech businesses joining these electronic payment platforms. Rules governing access to or participation in a payment system are required to be objective, proportionate and non-discriminatory. The Payment Systems Regulator is responsible for upholding the prohibition against restrictive rules on access to payment systems. Enhanced competition is one of the objectives of the second Payment Services Directive (EU) 2015/2366 (PSD 2) which has been implemented in the UK via the Payment Services Regulations 2017.

ELECTRONIC MONEY ISSUERS

The FCA Handbook contains a number of electronic money-related rules, directions and guidance aimed at businesses that are issuing or considering the issuing of electronic money (e-money). In addition to the FCA Handbook, the law governing the issuance of electronic money is the Electronic Money Regulations 2011. E-money is defined as electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions. E-money must be accepted by a person other than the electronic money issuer and include pre-paid cards and electronic pre-paid accounts for use online. Generally, firms issuing e-money must be authorized or registered with the FCA.

PEER-TO-PEER LENDERS

A person carries out a regulated activity (requiring authorization by the FCA) if they facilitate lending and borrowing between two individuals or between individuals and businesses of less than £25,000 in circumstances where the borrower does not enter into the agreement wholly or predominantly for business purposes. Such agreements are known as Article 36H Agreements and will only be caught by the regulations where either the lender or the borrower is an individual or a partnership with two or three persons or an unincorporated body.

Regulation of payment services

Where a UK business provides payment services as a regular occupation or business activity in the UK, it will require authorization by the FCA to become an authorized payment institution under the Payment Services Regulations 2017. Failure to obtain the required authorization is a criminal offence. The regulations implement the European Union Payment Services Directive II.

In order to become authorized by the FCA as a Payment Institution, a payment services business will need to meet certain criteria, including in relation to its business plan, initial capital, processes and procedures in place for safeguarding relevant funds, sensitive payment data and money laundering and other financial crime controls.

The FCA has published an Approach Document on the FCA's role under the Payment Services Regulations 2017 and the Electronic Money Regulations 2011. It gives readers a comprehensive picture of the payment services and electronic money regulatory regime in the UK. It also provides guidance for a practical understanding of the requirements, the FCA's regulatory approach and how businesses will experience regulatory supervision.

Application of data protection and consumer laws

The UK's Data Protection Act 1998 (DPA) regulates the processing of personal data within the UK. The DPA implements the European Data Protection Directive. Where a business determines the purposes and manner in which any personal data is processed, it will be regulated by the DPA and have certain notification and compliance obligations.

The European General Data Protection Regulation (EU) 2016/679 (GDPR) came into effect on 25 May 2018. As a result of GDPR, the DPA has been amended and replaced with the Data Protection Act 2018. The GDPR is more prescriptive and restrictive, compared to the principles-based DPA, including mandatory notifications where a breach occurs and provide for severe monetary sanctions for breach. GDPR sets the key principles, rights and obligations for most processing of personal data. As a European Regulation, it has direct effect in UK law and automatically applies in the UK until the UK leaves the EU. After this date (Brexit), GDPR will continue to apply in the UK as a result of the European Union (Withdrawal) Act 2018, with some technical changes to make it work effectively in a UK context.

The UK's Privacy and Electronic Communications Regulations 2003 (PECR) regulate unsolicited direct marketing by electronic means, in addition to sector specific regulations, such as the FCA's financial promotions regime. PECR has been updated in light of GDPR and uses a new standard of GDPR consent.

Money laundering regulations

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 give the FCA responsibility for supervising the anti-money laundering controls of businesses that offer certain services, such as lending, providing payment services and issuing and administering other means of payment.

Generally, where a firm is authorized and supervised by the FCA it will also be authorized and supervised by the FCA for complying with anti-money laundering requirements.

The MLRs have been updated to implement the Fifth Anti-Money Laundering Directive (EU) 2018/843. These changes include bringing into scope of the MLRs the following firms:

- cryptoasset exchange providers (including Cryptoasset Automated Teller Machine (ATM), Peer to Peer Providers, Issuing new cryptoassets, e.g Initial Coin Offering (ICO) or Initial Exchange Offerings); and
- custodian wallet providers.

Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk. Cryptoasset exchange providers and custodian wallet providers are required to register with the FCA and comply with the MLRs.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals, (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital providers.

CROWDFUNDING

The crowdfunding sector is well established, and may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform, such as Crowdcube or Crowdfunder.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

There are various incubators or accelerators in the UK market, which offer support, facilities and funding for startups, often in return for an equity stake. For example, Barclays has an accelerator program which offers up to US$120,000 investment from Techstars, together with mentoring from industry experts.

Venture capital and debt

Venture capital funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. Venture capital provides a viable alternative to traditional lending, given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of venture capital and involves an equity investment by a corporate fund, examples of which include Santander InnoVentures and Citigroup's Citi Ventures. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Some FinTech companies may see warehouse funding as a temporary form of financing to be followed by a larger capital markets transaction at a later date.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms, such as Zopa and Funding Circle, which bring individual borrowers and lenders together without the involvement of traditional banks. P2P lending does not involve equity investments; interest is paid on the money borrowed instead.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

The UK has both debt and equity capital markets which are accessible to businesses (usually of a certain size).

Raising finance by way of an Initial Public Offering (IPO) is a popular funding arrangement for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange, such as the London Stock Exchange. The London Stock Exchange's Alternative Investment Market (AIM) caters specifically for small, growth-orientated companies.

A number of marketplace loan securitizations have been launched in the UK, where loans originated via marketplace lending platforms are packaged together and sold to investors as bonds by companies such as Funding Circle and Zopa.

FinTech companies have also accessed funding by issuing bonds to retail investors as a way of raising more competitive funding. For example, in July 2017 LendInvest issued an initial £50 million of retail bonds, which are tradeable on the LSE.

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes, which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

The Seed Enterprise Investment Scheme (SEIS) is designed to help small, early-stage companies raise equity finance by offering 50% income tax relief for individuals who invest in the shares of qualifying startups, up to a maximum investment of £100,000 per annum. This scheme complements the Enterprise Investment Scheme (EIS), which offers a lower rate of income tax relief of 30% to investors in higher-risk small companies. It is worth noting that some financial activities, such as money lending or insurance are non-qualifying trading activities, and as such, EIS and SEIS may not be available for all FinTech companies.

In addition, research and development (R&D) tax credits are an incentive designed to encourage companies to invest in R&D. SME businesses (those with fewer than 500 employees, and either revenue less than €100 million or balance sheet assets less than €86 million) can benefit from up to 230% tax relief on their R&D expenditure.

The Patent Box Scheme enables companies to apply lower rate of Corporation Tax (10%) to profits earned from its patented inventions.

Finally, since 6 April 2017, payments of interest made by a UK borrower to a UK lender through a UK peer-to-peer platform are exempt from withholding tax provided that certain conditions are met. To avail the exemption, the credit provided by the lender to the borrowers needs to have been provided at the invitation of a regulated operator of an electronic system.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Novation** – A novation is a full legal transfer of the party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a fresh contract being formed between the continuing party and the transferee and the transferor being released from its obligations.
- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. An assignment can be effected as either an equitable assignment or legal assignment depending on whether certain statutory requirements have been satisfied.
- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;

- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

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Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in the UK varies according to the asset class. The main asset classes are usually considered to be:

- economic infrastructure (energy, aviation, rail, telecommunications, water, roads and waste); and
- social infrastructure (education, health and justice/prisons, housing).

The UK government has announced that Private Finance Initiative (PFI) or Public Private Partnership (PPP) models may no longer be utilised in England and Wales. Until this policy is changed, investment and lending opportunities are therefore likely to be found in economic infrastructure with the exception of some opportunities in the social housing sector. The Welsh and Scottish government continue to utilise PPP-style models on certain projects using the Mutual Investment Model (MIM) and the Non-Profit Distributing (NPD) model respectively.

Key sectors are considered below.

Energy

The gas and electricity industries in the UK are privatized, with the generation, transmission, distribution and supply services provided by a number of private sector companies. The relevant private sector companies own the generation, transmission and distribution assets. Notably, the National Grid, a listed public company (albeit heavily regulated) owns all of the mainland transmission lines. On certain offshore projects, private entities other than the National Grid may own transmission lines.

The private sector finances and delivers most of the required infrastructure but there are a number of government policy mechanisms (adopted through legislation) which are used to incentivize investment in eligible energy generation technologies. In certain instances, including on major energy infrastructure, projects may be procured by the public sector and depending on the terms of the procurement, the asset may either be publicly or privately owned.

The Office of Gas and Electricity Markets (Ofgem) (as governed by the Gas and Electricity Markets Authority) is the principal body with responsibility for regulation of the energy sector in Great Britain. There is a separate regulator (the Utility Regulator) for the energy sector in Northern Ireland.

Telecoms infrastructure

The telecommunications networks (fixed and mobile) in the UK are privately owned by a number of service providers. A good example is BT Openreach which is responsible for most of the UK's broadband infrastructure but whose work is heavily regulated by government; it, in turn, works with more than 500 service providers to provide local access to users.

The Office of Communications (Ofcom) is the regulator of the UK's telecommunications sector. It also has responsibilities for television broadcast services and wireless communications services.

Due to the UK government's focus on driving the digital transformation through enhanced telecommunications, recent years have seen Ofcom seek to address the issue of BT Openreach's strong position in the broadband access market by attempting to level the playing field in terms of access of BT Openreach's own network and infrastructure to other private providers and making it easier for such providers to build their own broadband networks. As a result, there has been an expansion of other providers building their own networks.

There has also been significant M&A activity in the ownership of telecommunications towers.

Transport infrastructure

LIGHT RAIL

Typically, light rail assets (such as trams and associated track) are owned by local public sector promoting bodies. For example, Transport for London owns the tubes, track and supporting infrastructure in London. Outside of London and on a small number of lines on the London Underground network, certain elements of light rail projects may be outsourced to the private sector; for example, the private sector may provide new trams, run a concession or operate and maintain a light rail system on behalf of a local transport executive – the assets will continue, however, to be owned by the public sector.

HEAVY RAIL

The rail market in the UK is privatized but its composition (which is complex) involves both public and private entities. The principal elements to the rail sector in Great Britain are:

- **Network Rail**, a private limited company, is on the public sector balance sheet and owns, operates and maintains rail tracks, signaling and station infrastructure. It is responsible for improving most of the regulated national rail infrastructure and for operating some of the stations on the national rail network. It is not responsible for the London Underground network, Crossrail and High Speed rail infrastructure.
- **Public transport authorities**, ie central and devolved government bodies and some metropolitan bodies, specify, let and manage operating contracts and give Network Rail a significant proportion of the funding for infrastructure maintenance and enhancement.
- **Train operating companies (TOCs)** are awarded franchises by the Department for Transport or local transport executives to operate certain train lines. 'Open Access TOCs' may apply to the rail regulator for use of certain train paths/routes when not being used by the franchised TOCs. Note that the UK government is currently reviewing the franchise system.
- **Freight operating companies (FOCs)** are wholly commercial entities.
- **Rolling stock companies (ROSCOs)** are private entities which own and maintain rolling stock and lease them to the TOCs for use on their franchise.
- **Project finance** – There have been limited deals (for example both phases of the Intercity Express Programme) where rolling stock has been procured through a PFI (Private Finance Initiative) / PPP (Public Private Partnership) project finance-style model and on that deal it is the private sector which owns the trains and will continue to do so following the expiry of the main contract with the public sector. The Thameslink rolling stock PPP also deployed elements of a PFI-style model albeit in a hybrid PFI/asset finance structure. Project finance structures have been utilised on other deals but they have tended to adopt alternative ownership and revenue models rather than a direct PFI-style availability model.

The rail sector is regulated by the Office of Rail and Road (ORR).

ROADS, BRIDGES AND TUNNELS

A government entity, Highways England, operates, maintains and improves the motorways and major 'A' roads (ie the strategic road network) in England. Highways England is regulated by the Office of Road and Rail and receives funding from the government for investment in the strategic road network (including additional road capacity). Local roads in England are the responsibility of local authorities. The public sector may outsource the construction, operation and maintenance (sometimes on a project financed basis) of such assets to the private sector. In the case of tolled roads, the private sector has taken on roads/crossings on a full concession basis – namely, responsible for the design, build, financing, operation, maintenance and collection of tolls for a number of years with the main revenue stream being the collection of toll revenues from users (rather than any service payments from the public sector) but these types of projects are no longer considered viable as the private sector is not willing to take 'demand risk' in order to service the upfront capital costs and associated bank debt. On more recent projects, the private sector provides toll collection services (in part) for a service fee rather than it solely relying on those tolls as its main source of revenue.

AVIATION

Aviation in the UK is (for the most part) privatized. As regards airport infrastructure, there are a number of ownership structures in the UK market, including private ownership, local government ownership and various forms of public-private ownership. All models are heavily regulated by government and the Civil Aviation Authority is the aviation regulator in the UK.

PORTS

The UK ports sector comprises a variety of company, trust and municipal ports, all operating on commercial principles, independently of government and largely without public subsidy. The private sector operates the vast majority of the UK's major ports.

Other infrastructure

SOCIAL INFRASTRUCTURE (SCHOOLS, HOSPITALS, EMERGENCY SERVICES HUBS AND PRISONS)

Typically, these are owned by the public sector with the exception of social housing projects (please see below) with the private sector's responsibility being for any or all of the design, build, financing, operation and maintenance of the infrastructure. The majority of social infrastructure assets in the UK are directly financed by the government. Subject to value for money considerations, historically private finance may also have been considered in the procurement of social infrastructure assets using the Private Finance Initiative and its successor , Private Finance 2 (PF2). However, the UK government has declared that PFI, PF2 or any other Public Private Partnership (PPP) model may not be used going forward. This means that likely financing model for future projects is through direct financing by government unless there is a change of policy. In relation to some of these specific sectors:

Education

The ownership of a school's infrastructure depends upon which category of school it belongs to. For example, in the case of a local authority maintained school, the school and playing fields will be owned by the local authority; and an academy school (which receives funding directly from the government) may lease land from a local authority.

Hospitals

Ownership of hospitals is vested in various public sector bodies operating within the National Health Service.

Social housing

This is a diverse sector involving many different organizations and individuals including housing developers, building contractors, mortgage lenders, local authorities, housing associations, landlords, owner-occupiers, private renters and those in the social rented sector. Typically, on a social housing project, housing associations own the relevant housing stock. Although housing associations tend to be private limited companies their governance is constrained by public sector regulation and, effectively, operate as quasi-public sector entities.

DEFENSE

Typically, defense assets are owned by the public sector.

WASTE

In the past, the public sector procured new waste treatment or collection facilities and these were owned by the public sector even if the private sector would be responsible for design, build, operation or maintenance of the facility. One example being long-term Private Finance Initiative (PFI) contracts with private sector companies in relation to the building and operation of waste infrastructure, with financial support being provided to the local authorities by the government through the PFI in respect of the cost of those projects. Increasingly, merchant facilities, namely those developed and operated by private sector entities, are being used and these facilities serve both their public sector and private sector customers. According to the Infrastructure and Projects Authority's *National Infrastructure Delivery Plan 2016-2021* (March 2016), the government is not planning to fund any new waste infrastructure projects beyond those in the pipeline.

WATER

Water and wastewater (sewerage) services in England and Wales are delivered by private sector companies (water companies) which own the relevant infrastructure assets. In Scotland and Northern Ireland, water and wastewater services are provided by state owned companies. The Thames Tideway Tunnel (a major new sewer) in London is being built and will be operated by a private sector company called Tideway, which is independent of Thames Water (the regional water company). The Water Services Regulation Authority (Ofwat) is the regulator of the water sector in England & Wales. The Northern Ireland Authority for Utility Regulation (NIAUR) is the regulator for Northern Ireland. The Water Industry Commission for Scotland (WICS) is the equivalent for Scotland.

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Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment in energy or infrastructure projects in the UK over and above existing regulation for investors and funders more generally but a particular proposed investment may be subject to legislative or regulatory control (eg merger control rules). As regards the planning and implementation of the underlying energy or infrastructure project (in which the investment is to be made), the legal/regulatory position relevant to that project must be considered. For example, a project involving development on land will require planning permission or a development consent order; and a project may require environmental authorizations/permits and/or sector specific regulatory consents or licenses. If a public body (eg a government department, a local authority or a National Health Service Trust) is procuring a project using private finance, and the public body is to benefit from central government funding towards the cost, the project will be subject to central government approval. Key sector-specific issues are flagged in the sections below.

Whether an investor can invest will depend on the terms of the procurement of that project if it is a public sector project and, in respect of an existing/operational project, that will depend on whether there are any contractual restrictions on 'Change of Control'. This is less of a concern on private sector infrastructure although investors would need to consider whether any licenses/consents/permits would be affected by their acquisition of an interest.

Energy

The energy markets in the UK have a complex system of arrangements between suppliers, generators, transmission and distribution which are heavily regulated. In particular, there are complex arrangements in respect of licensing, subsidies and demand/charging mechanism with suppliers, customer and the National Grid and these are subject to change/regular updates meaning that investors will need to have a good understanding of the current framework and the potential directions in which the market may move. Investors need to understand how technology changes may impact on the overarching regulatory framework and vice versa.

Investors should also consider whether the acquisition of any interests in the energy sector (at an entity or asset level) would cause any issues with any license conditions or the granting of specific subsidies. In particular, if a breach of those conditions could lead to the revocation of a license/subsidy that might make the potential target less attractive or viable.

Telecoms infrastructure

There is a complex regulatory environment for this sector including how access and interconnectors (between networks) are regulated under the Digital Economy Act 2017, Communications Act 2003 and the Communications (Access to Infrastructure) Regulations 2016 and how Ofcom grants rights to access private or public land in order to install and maintain essential equipment in, over or under that land. This equipment might be cables sunk beneath the ground or a mobile mast sited on the ground.

The industry is largely privatized, therefore investors should consider if any permits/consents/licenses will be affected by their interest.

Transport infrastructure

RAIL

There is an extensive and complex regulatory framework to consider in respect of a practical and operational involvement in this sector. Key areas include understanding the regulatory regime for certification for train use and acceptance and user fare regulation. Depending on how an investor wishes to invest in a project (specifically what type of entity or asset), there is a varying degree of difficulty for investors to enter into an existing project. For example, rolling stock operating companies (ROSCOs) are privately owned companies where third party investment is relatively common whereas train operating companies (TOCs) are often special purpose vehicles so, in theory, investment into a TOC should be relatively straightforward. However, any change in control of a TOC under a Franchise Agreement will usually require a consent from the Department for Transport. Note that the UK government is currently reviewing its policy on rail franchising and the market is expecting changes to be made to the current model.

ROADS

In order for a private sector partner to carry out its duties on certain types of roads projects, the procuring public sector authority (Highways Agency or a local authority) may delegate certain of its statutory duties to the private sector partner. This will be dependent on the project and the specific contractual requirements. Any investor will, therefore, need to understand those duties and whether it is able to subcontract those duties to an appropriate person. There is usually a restriction on the change of control of the private sector partner during the construction period. Following the construction period, the private sector may be allowed a change of control provided that they do not fall within a definition of an '*Unsuitable Third Party*' (which may include concerns about national security, tax avoidance). The precise scope of the restrictions will depend on the contractual terms.

Other infrastructure

On publicly-procured infrastructure, it is quite common for long-term projects to have a 'change in control' clause which restricts change in ownership structures of the private sector. For example, in most sectors there is a restriction on change in control during the construction period but this is often relaxed post construction provided any change in control is not to an 'Unsuitable Third Party'. How strict these restrictions are will often depend on the sector. For example, the defense sector usually gives the Ministry of Defence a strong degree of discretion (particularly on the grounds of national security) as to whether to accept a change in control over its private sector partner.

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What is the applicable procurement process?

Public procurement in England & Wales is, for the time being, in most instances governed by the Public Contracts Regulations 2015 which is based on EU Directives. There are some sector-specific regulations such as the Utilities Contract Regulations 2016 (applicable to the rail sector, water and energy) and the Defence and Security Public Contracts Regulations 2011 (which are also based on EU Directives and therefore this entire framework is subject to change as the UK leaves the EU).

The key principles are that any contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

Investing in energy and infrastructure

Public procurement is relevant where the UK government, or a branch of it, is seeking to outsource delivery of a new project. On an infrastructure project, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal which could include design, build, operation, maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies to certain public bodies including central government departments, local authorities, police and fire authorities, NHS Trusts, various non-governmental bodies such as the Competition and Markets Authority and the House of Commons. A regulated procurement is required where certain financial thresholds are met and on most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met so a regulated procurement would need to be run.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (**OJEU**) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects and tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.
- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage and tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.

- **Competitive dialogue** – This is often the most common procedure for complex infrastructure projects and involves a shortlisting of at least three bidders who are invited to dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer's bid.
- **Competitive procedure with negotiation** – This is sometimes described as a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation is not allowed following final tender.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the original awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest or variation to the existing project may have procurement-related considerations that need to be borne in mind.

Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, on project finance deals, a refinancing of the senior debt will require the consent of the public sector and any refinancing gains to be shared with the public sector.

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What are the most common forms of funding / investing in energy and infrastructure?

The principal forms of **private** sector funding/investment in energy and infrastructure in the UK (including in relation to public-private partnerships) are:

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders. For publicly procured project financed deals, this has traditionally meant using the PF2 or Private Finance Initiative (PFI) model since the UK government announced that such models can no longer be used, the market had adapted to provide financing on private sector-initiated energy and infrastructure projects;
- syndicated to other funders. (For publicly procured project financed deals, this often means using the PF2 model which is a successor to the Private Finance Initiative (PFI));
- bond finance;
- mezzanine debt (in some sectors);
- refinancing of the debt in operational projects; and
- asset financing this is particular relevant in the rail sector.

Funding/funding products can also, sometimes, be provided by the European Investment Bank and export credit agencies.

Investing

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

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Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the Financial Conduct Authority or the Prudential Regulatory Authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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What regulatory penalties may apply?

When a rule breach has taken place, the Financial Conduct Authority or the Prudential Regulatory Authority have a variety of regulatory penalties they may impose depending on the seriousness of the matter. These include:

- withdrawing a firm's authorisation;
- prohibiting individuals from carrying on regulated activities;
- suspending firms and individuals from undertaking regulated activities;
- issuing fines against firms and individuals who breach the rules or commit market abuse such as insider dealing;
- issuing fines against firms breaching competition laws;
- making a public announcement and publishing details of a warning, decision or final notices;
- applying to the courts for injunctions, restitution orders, winding-up and other insolvency orders;
- bringing criminal prosecutions for financial crime, such as insider dealing, unauthorised business and false claims to be authorised; and
- issuing warnings and alerts about unauthorised firms and individuals and requesting that web hosts deactivate associated websites.

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What criminal penalties may apply?

Following formal investigation, the regulators have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the Money Laundering Regulations; and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

ADVANCE OF LOAN

No stamp, registration, transfer or other similar taxes are payable on the advance of a loan.

TRANSFER OR ASSIGNMENT OF A DEBT UNDER A LOAN

A written instrument transferring or assigning a debt under a loan is, in principle, chargeable to 0.5% UK stamp duty. An agreement to transfer a debt is also, in principle, chargeable to UK stamp duty reserve tax (SDRT) (although, in practice, a payment of both UK stamp duty and SDRT should not be required). However, provided the debt constitutes loan capital and does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into shares or other securities), the written instrument assigning or transferring, or the agreement to assign or transfer, such debt should be exempt from both UK stamp duty and SDRT. This is known as the loan capital exemption.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

There is no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

However, most security interests created by English companies and English limited liability partnerships must be registered at Companies House to perfect the security and ensure it is valid against third parties. The grant of most security interests over UK real estate should also be registered at the Land Registry (in the case of real estate in England and Wales) and the Scottish Land Registry (in the case of real estate in Scotland) to ensure that the security interest takes effect as a legal charge. It would be unusual for the fees payable for such registrations to be a material amount.

Other forms of registration may also be required (or be advisable), depending on the nature of the asset over which security is taken. Such registrations may also require the payment of fees.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

ISSUE OF DEBT SECURITIES

Bearer bonds

The issue of a debt security in the UK which is a bearer bond or the issue by or on behalf of a UK company of a debt security which is a bearer bond, in principle, gives rise to a charge to UK bearer instrument duty (BID). Such BID is chargeable at a rate of 1.5% of the issue price of the bearer bond. However, currently, HM Revenue and Customs is not seeking to collect BID on the issue of a debt security which is a bearer bond.

Registered bonds

Subject to the special regime for issues into a depository or clearing system (see below), there is generally, no charge to UK stamp duty or SDRT on the issue of a debt security which is a registered bond. The issue of a debt security which is a registered bond should also not give rise to a charge to BID (which is only relevant to bearer instruments).

TRANSFER OF BONDS

Bearer bonds

The first transfer in the UK of a debt security which is a bearer bond issued outside of the UK by a non-UK company, in principle, gives rise to a UK bearer instrument duty charge (if stamp duty would have been payable on the instrument of transfer if the bond had been in registered form). Such BID is charged at a rate of 1.5% of the transfer consideration. UK stamp duty only applies in respect of written instruments of transfer and so is not, normally, relevant to the transfer of a debt security which is a bearer bond, provided it is transferred by delivery. However, any agreement to transfer a bearer bond issued by or on behalf of a UK company is, in principle, chargeable to SDRT. Such SDRT is charged at a rate of 0.5% of the transfer consideration.

Registered bonds

A written instrument transferring a debt security which is a registered bond is, in principle, chargeable to UK stamp duty if the instrument is executed in the UK, or relates to UK stock or marketable securities or to something done, or to be done, in the UK. Any agreement to transfer a debt security which is a registered bond issued by a UK company or registered in a UK register is also, in principle, chargeable to SDRT. Such UK stamp duty and SDRT are chargeable at a rate of 0.5% of the transfer consideration.

DEPOSITARY AND CLEARING SYSTEMS

Bearer bonds and registered bonds

A written instrument transferring certain debt securities to a person whose business is, or includes, issuing depositary receipts or the provision of clearance services for chargeable securities (or the agent or nominee of such a person) is, in principle, chargeable to UK stamp duty. Such stamp duty is generally chargeable at a rate of 1.5% of the consideration or market value of the debt securities (depending on the circumstances).

The issue or transfer of certain debt securities to a depositary receipt issuer (or its nominee), where a depositary receipt is issued or to be issued, or the issue or transfer of debt securities into a clearing system (or its nominee) in pursuance of an arrangement for the provision of clearance services, in principle, gives rise to a charge to SDRT. Such SDRT is generally chargeable at a rate of 1.5% of the issue price, consideration or market value of the debt securities (depending on the circumstances). However, currently, HM Revenue and Customs is not seeking to collect SDRT on the issue, or (where integral to the raising of capital) the transfer, of debt securities into a clearing system or depositary receipt system, provided that the debt securities comprise loans raised by the issue of debentures or other negotiable securities for the purposes of Article 5(2)(b) of the Capital Duty Directive (2008/7/EC).

EXEMPTIONS

While in some circumstances, both UK stamp duty and SDRT may apply to the same transaction, as a general principle, there should be no double charge due to the operation of a franking system.

If a debt security benefits from the loan capital exemption, the issue or transfer of such debt security (whether a bearer bond or registered bond) should not be chargeable to UK stamp duty, BID or SDRT. The loan capital exemption applies to loan capital that does not have certain offensive features (such as a right to interest exceeding a commercial return or a right to conversion into share or other securities). The loan capital exemption is therefore the key exemption in the context of capital markets transactions and serves to exempt most vanilla bonds entirely from UK stamp taxes.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Secured lenders and secured debt security holders take priority over HM Revenue and Customs on enforcement of security.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Unless an exemption applies, where a payment of interest with a UK source is paid under a loan which is intended or expected to have a duration of a year or more, an amount equal to the basic rate of the interest payment is required to be withheld and paid to HM Revenue and Customs.

If so:
What is the rate of withholding?

The current rate of UK withholding tax (ie the basic rate) is 20%.

What are the key exemptions?

The most commonly relied on exemptions to ensure that interest payments made by UK companies can be made free of UK withholding tax include:

- the exemption for interest paid on an advance from a UK tax resident bank;
- the UK-to-UK exemption (applicable where interest is paid to a lender which is a UK tax resident company or a partnership of such companies);
- the quoted Eurobond exemption (applicable to interest paid on a security which is listed on a recognized stock exchange);
- reliance on a double tax treaty (such treaty may only provide for partial exemption);
- the qualifying private placement (the key requirement being the residence of the lender in a qualifying double tax treaty jurisdiction); or
- reliance on the EU Interest and Royalties Directive as implemented by UK law (the key requirement being that the lender and the borrower meet the association requirement).

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

The quoted Eurobond exemption is particularly relevant to debt securities.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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