2018 Strategic UK Regulatory Outlook

UK Regulatory and Public Policy (R&PP)

November 2017
Introduction

Political landscape:
It was a turbulent year for the UK with the triggering of Article 50, a ‘snap’ general election and a resulting weakened Government. However, big changes have not been confined to the UK, as illustrated by the results in the French elections.

UK economy:
Brexit dominated the economic agenda with the UK’s industrial strategy and the contents of a future trade relationship with the EU being key issues.

Regulatory change:
Against the political backdrop, the regulatory focus has been on necessary changes to UK law and proposals for key reforms in areas such as corporate governance (including the governance arrangements of large private companies), executive remuneration, corporate reporting, data protection, including the EU General Data Protection Regulation (GDPR), and corporate culture.
Introduction

Looking ahead to 2018 - selected key themes

Expect 2018 to be set against a backdrop of geopolitical uncertainty. This may influence UK, EU and international regulatory and public policy approaches going forward.

The regulatory and legislative changes arising from the UK's departure from the EU will not come into effect until 2019, or possibly beyond. However, corporates with EEA customers or supply chains, particularly those carrying out cross-border services into the EEA, will need to monitor the emerging direction of travel.

Although no proposals have been published to extend cyber security and cyber resilience requirements for all corporates, the GDPR is likely to be a catalyst for a change in approach. High profile cyber security incidents are likely to continue in 2018, potentially leading to greater supervisory focus from regulators.

Corporate culture, business ethics and rebuilding trust in business are likely to be at the heart of many public policy and regulatory developments in 2018 and beyond.

Overhauling the UK's corporate governance regime is a key priority for Government in 2018. Regulatory reforms are in progress at the Financial Reporting Council (FRC).

In the area of corporate reporting there will be continued developments to enhance transparency, increase the focus on the long-term and develop reporting to better serve a wider range of stakeholders.

Financial and corporate crime will remain a salient topic for the Government and regulators. Changes to legislation and regulation are to be expected. Financial services firms and others in the regulated sector should monitor the progress of the fifth Money Laundering Directive, whilst all corporates should look out for a package of reforms the Government is expected to announce to enhance the UK's response to economic crime.

Data protection laws are set to be strengthened, with organisations subject to more stringent requirements on the use of personal data, greater accountability and tougher new penalties.
## 2018 Strategic UK Regulatory Outlook - selected key themes

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Geopolitical uncertainty
This backdrop of geopolitical uncertainty may influence UK, EU and international public policy and regulatory approaches

Globalisation vs protectionism

- The idea of globalisation is being challenged. In different parts of the world there are polarising shifts in how countries want to operate.
- In various parts of western democracies there is a push towards protectionism.
  - The shift towards anti-globalisation is a result of the financial crisis and the sense that globalisation has left people feeling disenfranchised.
- Whereas Asia is becoming a supporter of globalisation and is seeking to increase trade and access to more markets.

Examples include:

USA
Under the Trump administration, the USA is steering towards protectionism (i.e. “America First”) and deregulation with, for example, the following potential policy reforms:
- Repeal of the Dodd Frank Act.
- Withdrawal from the Paris Climate Change Accord.

There have also been fears of a potential trade war with China.

UK
Despite the decision to leave the EU, there is a conflict between protecting local jobs and the desire to remain global and be part of the EU single market.

France and Germany
In other areas of the EU we see an increase in countries becoming more inward looking and politically volatile e.g.:
- French President Emmanuel Macron seeks reforms that move towards the deregulation of the French labour market.
- In Germany, far right nationalist party AFD gained more seats in the Bundestag.

China
President Xi Jinping’s public support for globalisation shows that China is seeking to increase its presence in the global economy, with policies to open its domestic markets to more imports and foreign direct investment. Strong global growth from Asia could lead to pressure on resource needs.

Three uncertainties to watch for are:

1. The continued increase in protectionism.
2. Risks to the availability of resources as a result of geopolitical factors i.e. non-renewable assets, people and capital.
3. The increased role of Asia in the growth of the global economy.

As technological, demographic and climate pressures intensify the danger of systems failure, competition among world powers and fragmentation of security efforts makes the international system more fragile, placing collective prosperity and survival at risk – World Economic Forum 2017
Cybersecurity and cyber resilience

High profile cybersecurity incidents are likely to continue in 2018. Therefore this issue will remain high on the agenda of the Government and regulators: companies should expect to see greater supervisory focus.

- The Government and regulators are strengthening legislation and regulations concerning the protection of personal data and the management and oversight of cyber risks in sectors like financial services where such risks could create systemic failures.

- Two main regulatory changes to prepare for are the General Data Protection Regulation, and the Security of Network and Information Systems Directive.

**General Data Protection Regulation (GDPR)**

GDPR will apply in the UK from 25 May 2018 and will replace the existing EU framework for the protection and use of personal data. One of the key changes will be a requirement that a personal data breach must be notified to a supervisory authority within 72 hours of data controllers becoming aware. See our Data Protection section for more information.

**The Security of Network and Information Systems Directive (NIS)**

Consultation on the UK implementation of the NIS closed on 30 September 2017. The deadline for transposition into UK national law is 9 May 2018.

The aim of the NIS is to boost the overall level of cybersecurity in the EU and develop a ‘culture of security’ across sectors, especially those with significant infrastructure implications, including utilities, transport, banking, healthcare and digital.

Under the NIS Member States will need to be prepared and appropriately equipped, e.g. via a Computer Security Incident Response Team, a national NIS Competent Authority and a Single Point of Contact (in the UK this is expected to be the National Cyber Security Centre).

Operators of essential services will be required to take appropriate and proportionate measures to manage risks to their security and information systems and notify serious incidents to the national competent authority. Key digital service providers will also be subject to security and incident reporting requirements.

According to EY’s Global Information Security Survey (GISS) 86% say their cybersecurity function does not fully meet their organisation’s needs.

Alongside the increased cost of cybercrime which runs into an average of more than US$ 17 million (£13m approx.) for organisations in industries like Financial Services, Utilities and Energy – attackers are getting smarter – Ponemon Institute 2017.
Convergence of disruptive innovation and the impact of technology
Technology is creating new challenges for regulation

Technological disruption continues at a pace

► Technological advances have become one of the key forces driving change and causing disruption.
 ► Emerging technologies are disrupting existing business models.
 ► As disruptive technologies go mainstream, new solutions and new companies emerge that disturb market dynamics.
 ► The World Economic Forum identified emerging technology as a key global risk.
 ► Independent research by Gartner predicts 85% of customer interactions will be managed without a human by 2020.

Where next for regulation?

► Many emerging technologies, including artificial intelligence, raise complex moral and ethical questions. For example, issues surrounding the transparency of algorithms or the risk of biased data.
 ► As well as benefits, new technology presents the risk of negative consequences. Some of these risks are well documented and others are yet to be fully assessed.
 ► Regulation of emerging technologies will be challenging, but crucial for balancing the potential benefits and risks while fostering innovation.
 ► Regulation of emerging technologies is currently uneven and patchy. Some areas are heavily regulated whereas others are subject to relatively little scrutiny.
 ► The exponential growth of data is making it increasingly difficult for regulation to keep pace with new technology. In the absence of prescriptive rules, ethical norms may become even more important to provide a moral guide for organisations to behave in the public interest.
Uncertainty around Brexit persists. The UK’s exit from the EU will have implications for people and businesses throughout Europe and beyond. The nature of these implications remain unclear. Much will depend on what future relationship between the UK and the EU emerges.

There have been six rounds of negotiations on the withdrawal agreement but talks have not yet moved on to mapping the UK’s post-Brexit relationship with the EU. The prospect of a transition period or a ‘no deal’ scenario remains possible.

Expect the Brexit legislative agenda to take precedence throughout 2018. The European Union (Withdrawal) Bill continues its passage through Parliament. Hundreds of amendments have been proposed. Parliament will also vote on the final deal. In addition, a further seven Brexit-related Bills and an estimated 800 to 1,000 statutory instruments are thought to be needed to have a fully functioning UK Statute Book on 30 March 2019. The House of Lords Delegated Powers and Regulatory Reform Committee met for the third time this Parliamentary session and raised many constitutional issues with the European Union (Withdrawal) Bill.
Culture, ethics and trust
Three pieces of the puzzle to rebuild confidence in business

- There is continued interest in corporate culture among regulators.
- The FRC will publish a thematic review on audit firm culture in 2018, building upon an earlier (2016) report on Corporate Culture and the Role of Boards.
- Many recent corporate failings have been found to have had their roots in cultural shortcomings.
- Getting culture, ethics and trust right can also have a positive impact on business performance.
- As intangible assets make up an ever larger proportion of companies’ value, investors are demanding greater assurance over those intangibles. Culture is one such asset.

- Analysis by the ACCA found 8 in 10 professional accountants believed ethical principles and behaviour will become more important in the digital age.
- A white paper by MindGym argues that spending on compliance, while well intended, does not always deliver results and can even be counterproductive. An ethical company must be built from the ground up.
- Populus, the consumer research agency, has been tracking companies’ reputations amongst the public. Almost all low scoring companies have had to withstand political pressure.
- The 2017 Edelman Trust Barometer reveals the general population’s trust in all four key institutions (business, Government, NGOs, and media) has declined.⁴
Corporate governance reform
A key priority for the Government, 2018 will bring reforms to the UK's corporate governance regime

Background

- August 2017: The Government published a response to its Green Paper on corporate governance reform, which received 375 submissions. The Green Paper outlined the Government’s corporate governance reform agenda to enhance trust and confidence in big business. It covered:
  - Executive pay
  - Strengthening the employee, customer and supplier voice, and
  - Corporate governance in large private businesses.


The road to reform

Stewardship Code Consultation
Winter 2018: the FRC is expected to conduct a full consultation on updates to its Stewardship Code.

Corporate Governance Code
Summer 2018: the FRC is expected to publish the revised Code to reflect consultation feedback and engagement with other organisations. The revised Code is likely to be effective for financial periods beginning on or after 1 January 2019.

Guidance on the Strategic Report
Spring 2018 onwards: the FRC is expected to issue updated Guidance on the Strategic Report. See Corporate Reporting page for more detail.

Corporate Governance Code Consultation
Winter 2017: the FRC will consult on changes to the Code - taking into account the Government’s response to its Green Paper - and the Guidance on Board Effectiveness. Additionally there will be a preliminary consultation on the Stewardship Code.

Listen to the podcast from the FRC
Financial and corporate crime
The National Crime Agency estimates fraud losses in the UK are increasing and could be as much as £193 billion.
Corporate reporting
2018 will see continued changes to corporate reporting to enhance transparency and rebuild trust

Non-Financial Reporting Directive (NFRD)

NFRD requires large companies and qualifying partnerships with more than 500 employees to disclose information about, amongst other things, their environmental risks, anti-corruption and bribery issues, human rights and boardroom diversity. The NFRD has been implemented in the UK via a revision to the Companies Act 2006. The changes apply for financial years beginning on or after 1 January 2017.

Guidance on the Strategic Report

The FRC is updating the Guidance to reflect the NFRD along with providing more detailed guidance to reflect the duties of directors under s.172 of the Companies Act 2006. The consultation was concluded on 24 October 2017. Final guidance is expected to be published in the first half of 2018.

Energy and carbon reporting

The Department for Business Energy & Industrial Strategy (BEIS) has published a consultation on its proposals for a simplified UK-wide energy and carbon reporting framework. The new framework is due to be implemented by April 2019. Proposals include requirements for quoted companies to disclose their total global energy use across all energy types in the annual report.

Gender pay gap

Employers in the UK with over 250 employees are required by law to publish four types of figures annually on their website:
- Gender pay gap (mean and median averages)
- Gender bonus gap (mean and median averages)
- Proportion of men and women receiving bonuses
- Proportion of men and women in each quartile of the organisation’s pay structure

The deadline for companies to report is 4 April 2018 and annually thereafter.

Ethnicity pay gap

There is currently no regulatory requirement. However, companies are being encouraged to voluntarily report on their Ethnicity Pay Gap.

Modern Slavery Act 2015

A Private Members’ Bill has been introduced to the House of Lords. The second reading is yet to be determined but key changes being sought include:
- Making Section 54.5 compulsory.
- Mandating that the Secretary of State publishes a list of companies that come within the scope of the Act.

Companies who have taken no steps to ensure that slavery and human trafficking is not taking place in their business would need to state so and explain why.

In addition to the new reporting requirements, the Government is seeking reforms to corporate governance in the UK. See Corporate Governance page for more detail.
2018 will see the strengthening of data protection laws, with organisations subject to more stringent requirements on the use of personal data.

**General Data Protection Regulation**
- General Data Protection Regulation (GDPR) will apply in the UK from 25 May 2018.
- The Data Protection Bill, which is currently going through Parliament, aims to modernise UK data protection law.

**Key changes**
- Stricter requirements for the use of consent to justify data processing.
- Data Processors now have direct responsibilities of their own.
- New and enhanced rights for individuals as consent will need to be more specific and informed.
- Notification of personal data breaches must be made within 72 hours of data controllers becoming aware.

**Best practice becomes law**
- Data privacy by design and by default, to consider privacy from the start of all projects.
- Data Protection Impact Assessments, to identify the most effective way to comply with obligations.
- Records of processing activity, additional internal records for companies with more than 250 employees.

**Penalties**
- Breaches of GDPR requirements may lead to a fine of up to €20m OR 4% of gross annual turnover.
- The Security of Network & Information Systems Directive (NIS) will introduce wider incident notification reporting requirements and penalties for operators of essential services and key digital service providers (see Cyber Security and Cyber Resilience page for more information).
**Pension scheme governance / trustee responsibilities**

As part of their continued effort to enhance transparency and trust, 2018 will see an increased focus on pension scheme governance by the Government and regulators.

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<td>1</td>
<td>The Financial Conduct Authority (FCA) has stated - having conducted research into the asset management sector - that it has reasonable grounds for suspecting that there are practices which may be preventing, restricting or distorting competition. The FCA has referred this concern to the Competition &amp; Markets Authority (CMA), which in turn has launched an investigation into investment consultancy and fiduciary management services.</td>
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<td>2</td>
<td>The Pensions Regulator (TPR) has launched its 21st Century Trusteeship campaign. Its aim is to support and encourage trustee boards to focus on good governance. The campaign will be communicating extensively with trustees in the months ahead, to set the minimum standards for pension trustees.</td>
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<td>3</td>
<td>The Department of Work and Pensions (DWP) has published its response to the consultation on pension scams. The response confirms that the Government will impose a ban on cold calls, text messages and emails related to pensions. The ban on cold-calling is to be implemented by the Information Commissioners’ Office (ICO).</td>
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<td>4</td>
<td>TPR has explained who it regards as a professional trustee, and the powers it may use to impose monetary penalties against these individuals if their standards of trusteeship and governance fall short of the standards required by TPR and pensions regulation. TPR regards this as an important means of helping to achieve good outcomes for the members of pensions schemes.</td>
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<td>5</td>
<td>Early exit charges that can be applied to the funds of members of occupational pension schemes using the Defined Contribution (DC) flexibilities are now restricted under new regulation. The Government has also extended the prohibition on charges being applied to members to recoup commission payments made by service providers to advisers.</td>
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<td>6</td>
<td>Changes to the valuation of pension benefits containing guaranteed annuity rates were made by the DWP. The changes will become law by means of two statutory instruments. Both will come into force on 6 April 2018.</td>
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