

PSC Regime Update

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People with Significant Control – Update on Implications of Regime for Corporates

Changes from 26 June 2017 to the regime on people with significant control under the Companies Act 2006 further increase transparency over the ownership and control of UK companies and LLPs. This regime was originally introduced under the Small Business, Enterprise and Employment Act 2015. The changes are brought in under The Information about People with Significant Control (Amendment) Regulations 2017 and are designed to implement the EU Fourth Money Laundering Directive. They extend the regime for the first time to UK companies with shares admitted to trading on prescribed markets such as AIM. The rules apply to companies and groups of all sizes and have wide implications. This alert looks at the transparency provisions for corporates in light of the 26 June 2017 changes. The rules are intricate and the specific requirements depend on the facts.

Who needs to keep a PSC register?

Most UK companies have had to keep a register of people with significant control (“PSCs”) since 6 April 2016 and to make information from that register public since 30 June 2016. There are related statutory obligations both on companies to investigate people with significant control over them and on registrable persons to disclose information. Breach of these obligations is a criminal offence. However, when the PSC regime was introduced there was an exception from the need to keep a PSC register for UK companies which were subject to Chapter 5 of the Financial Conduct Authority’s Disclosure Guidance and Transparency Rules (“DTR 5”) (primarily companies with shares admitted to trading on the Main Market of the London Stock Exchange or on AIM) or alternative disclosure rules designated as equivalent. Equivalency was given to companies with voting shares admitted to trading on an EEA regulated market and those listed on certain markets in Japan, the US, Switzerland and Israel.

The effect of the 26 June 2017 changes is to remove the exemption for DTR 5 issuers and replace it with a more limited exemption for companies with voting shares admitted to trading on a regulated market in an EEA state. The effect is that UK companies with shares admitted to trading on prescribed markets such as AIM no longer have an exemption and now have to keep a PSC register. Under transitional provisions, companies have until 24 July 2017 to set up a PSC register for the first time and commence filing obligations. However, the obligation to investigate and obtain PSC information takes effect from 26 June 2017. The separate designation of equivalency for companies listed on certain markets in Japan, the US, Switzerland and Israel is unaffected.

Time periods for entries and updates on PSC register and notifying Companies House

In the past PSC information has been updated through a company's annual confirmation statement. The effect of the 26 June 2017 changes is that, instead, Companies House must be notified each time there is an entry or a change. A company subject to the PSC regime will have 14 days from obtaining PSC information to make entries on its PSC register or update the register and another 14 days to notify Companies House. Previously there was no set time limit for updating the register and the public record at Companies House only had to be updated once a year through the annual confirmation statement (save for where, rarely, a private company had elected for its PSC register to be held centrally at Companies House).

What are the specified conditions for being a PSC?

A PSC is an individual that satisfies at least one of five possible conditions. A legal entity may also be treated as having significant control if it would have satisfied any of these conditions were it an individual. Further, a government or government department of a country or territory or part of a country or territory is treated as an individual for these purposes and, consequently, will also be a PSC if it satisfies any of these conditions. The conditions are:

- (i) holding, directly or indirectly, more than 25% of the shares in the company;
- (ii) holding, directly or indirectly, more than 25% of the voting rights;
- (iii) holding the right, directly or indirectly, to appoint or remove a majority of the board;
- (iv) having the right to exercise, or actually exercising, *significant influence or control* over the company (“**SIOC**”);
- (v) being an individual which has the right to exercise, or actually exercises, SIOC over a trust or firm which itself satisfies at least one of the above conditions.

Modified versions of these conditions apply to LLPs keeping a register. For example, the first condition becomes a right to share in more than 25% of the LLP's surplus assets on a winding up.

Who must be included on a company's PSC register?

- Any individual who is both a PSC in relation to that company and is registrable (discussed below).
- Any relevant legal entities which are registrable. A relevant legal entity (“**RLE**”) is: a body corporate or firm which has separate legal personality (such as a company or an LLP); and would have been a PSC in relation to that company were it an individual; and is subject to its own disclosure rules (either because the PSC regime applies to it, or it has voting shares admitted to trading on a regulated market in an EEA state (previously this was a wider definition covering DTR 5 issuers), or it is subject to any of the designated equivalent disclosure rules discussed above).

A key aspect of the approach to registrability of legal entities within a corporate chain is to limit registrability to RLEs which have their own equivalent disclosure obligations anyway. The rationale is that there is no need for the PSC register to identify the people behind such RLEs, as this can be separately investigated. However, where the legal entities in the corporate chain are not registrable, because they are not subject to their own disclosure rules, you have to look through them and register individuals or RLEs above them in the chain who have a majority stake in them and are PSCs if the test for registration is met. The way that works, all such PSCs will be registrable unless they only hold their interest through a majority stake in one or more legal entities over which they have significant control and at least one of which is an RLE subject to its own disclosure rules (the “**chain exception**”). Where this exception is satisfied, only the first RLE in the chain which is subject to its own disclosure rules (starting from the company's immediate holding company upwards) need be registered, not PSCs holding indirect interests which feature above it in the chain. This also has the benefit of avoiding unnecessary duplicate entities within a corporate group.

So, does the chain exception mean that you can avoid disclosing individuals who are PSCs at the top of the corporate chain?

Not entirely. For example, a UK operating company (“**opco**”) maintaining a PSC register which has a UK registrable RLE (“**R**”) immediately above it in the corporate chain need only register R. However, if the entities above R in the chain are non-UK companies which are not subject to their own disclosure rules you would have to look through them when completing R’s own PSC register and potentially disclose on it individuals behind them who are PSCs. Inserting a UK registrable RLE directly above a UK operating company in this way can act as a helpful “blocker” to shield opco from having to disclose those individuals, but it moves the disclosure obligation higher up the chain.

How do indirect interests work?

When calculating whether the first three PSC conditions are met (on share ownership, voting rights and board control) you have to count indirect as well as direct interests. A person is treated as holding an indirect interest if it has a majority stake in a legal entity which holds the shares direct or a majority stake through a chain of majority-held legal entities, culminating in the immediate parent company which holds the shares direct. The effect is that you do not have to count indirect interests in a company which are held through chains of companies which are not majority-held, nor interests held through a trust or limited partnership, as these are not separate legal entities. However, this is only any help if there is no separate basis of significant control.

Are there other factors to take into account when calculating if the first three PSC conditions are met?

The shareholding calculations should be based on nominal value of issued share capital. The effect is that holders of options or warrants will not generally be caught by the share ownership PSC condition until such time as they exercise their options or warrants, although technically PSC conditions could be triggered if they are treated contractually as shareholders for voting or broader decision-making powers prior to exercise or the circumstances in which such rights are exercisable are within their control. When calculating shareholding percentages you should exclude shares which have been bought back and cancelled or are held as treasury shares. Where a share or right is held jointly, each person is treated as holding it in their own right. So, if two people have a joint interest in 26% of the shares, they are each registrable as a 26% holder. Likewise, where people have a joint arrangement to exercise all or substantially all their rights in a particular way, they are each treated as holding the combined shares or rights.

What about interests in companies held through a limited partnership?

English limited partnerships do not have separate legal personality and so are not registrable themselves in respect of their interests in a company. Individuals who are limited partners will not be registrable themselves under any of the first three PSC conditions solely by virtue of being a limited partner in a limited partnership with an interest in a company, as long as they do not participate in management of the partnership business and there is no separate basis of SIOC. However, the general partner will usually be a PSC and, depending on the legal form and structure, either the general partner and/or individuals or RLEs behind the general partner who are PSCs will usually be registrable.

From 24 July 2017 active Scottish limited partnerships will need to file PSC information at Companies House, as will general Scottish partnerships where all the partners are corporate bodies. They need to start identifying PSCs from 26 June 2017.

What is “significant influence or control” for the purposes of the fourth PSC condition?

SIOC is described broadly as the ability to direct actions of the company or ensure the company adopts desired activities. Statutory guidance provides a number of examples that will likely be deemed to be SIOC. These include absolute decision rights relating to running company business, such as adopting or amending the business plan, changing the nature of the business or making additional borrowing from lenders. However, veto rights for the purpose of protecting a minority interest are unlikely alone to be so. “Absolute” for this purpose means a person has the ability to make or veto a decision without referring to or collaborating with anyone else. Whether a person actually exercises SIOC will depend on the cumulative effect of all relationships the person has with the company, and would include a person whose “recommendations are always or almost always followed”.

Examples of “excepted roles” that will not, usually, result in SIOC include directors, employees, professional advisers and those dealing with the company under commercial arrangements. However, the exceptions will only apply if there is no other basis of SIOC and the relationship does not go beyond the role as generally understood.

What issues may arise in a joint venture (“JV”) context?

The general rules for determining whether a person meets any of the PSC conditions will apply. Particular issues will arise where there is an overarching shareholders’ agreement (“SHA”) or there are separate voting arrangements between parties. The analysis will be fact-specific and will vary depending on the terms of the SHA and how the reserved or special approval matters are structured, but the following issues will likely need consideration:

- A person who holds, directly or indirectly, more than 25% of the shares in the JV company will fall within the first condition or, of voting rights, within the second condition.
- The third condition, on board appointment, requires assessing whether anyone has the right to appoint or remove directors who carry a majority of the board votes on all or substantially all matters, taking into account any weighted or otherwise differing voting rights and whether someone has a casting vote.
- Any parties which have joint arrangements to vote their shares together on substantially all their rights may be treated as holding their combined aggregate total of shares.
- Veto rights on appointment of a majority of directors could amount to SIOC. However, an appointment or veto right which is spread among a group of parties but does not sit with any one party will not amount to SIOC if no party can do it without collaborating with someone else and there are no joint voting arrangements between them nor any separate basis of SIOC.
- SIOC can arise where someone regularly directs or influences a significant section of the board or is regularly consulted on board decisions and their views influence them. A member of a majority shareholder’s group who exerts such influence through the group’s nominated director on the JV board could potentially be caught by the SIOC condition. Conversely, although in itself being an employee or director are excepted roles, a JV director to whom key decisions have been delegated by a nominating majority shareholder could also be caught.

What issues may arise where interests in companies are held through trusts?

The analysis will again be fact-specific, and the following factors will likely need consideration:

- Trustees holding shares direct will generally satisfy the PSC share ownership condition if the threshold of more than 25% is reached. Indirect interests held through a trust or firm generally need not be counted as this is only required where shares are held through a legal entity, but the requirements will depend on the facts. However, trustees of a bare trust will be treated as mere nominees, meaning the shares will be treated as held by the beneficiaries on whose behalf they act.

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- Where a trustee is a corporate, the general rules on registrable and non-registrable RLEs will apply.
 - Trustees exercising SIOC may be registrable under the general SIOC condition.
 - Where shares are held through a trust which itself satisfies a PSC condition, any individual who can or does exercise SIOC over the trust may be registrable on the company's PSC register. Depending on the facts, a beneficiary (or, indeed, a settlor) could be caught by this, even though a beneficiary would not otherwise be a PSC. The test is whether a person has the right to direct or influence the running of the trust's activities, including the right to appoint or remove any trustees or direct distribution of trust assets or investment decisions or amend or terminate the trust.

Are there ways to minimise application of the PSC regime?

Although the PSC regime is widely-drawn, there may be ways to contain its application. Introducing a registrable RLE "blocker" into a corporate chain may help shift disclosibility of ultimate PSCs higher up the chain and avoid it at opco level. Dis-aggregation of shareholdings so that they are held through a series of holdings of 25% or less may help avoid triggering the PSC condition relating to share ownership, but will not assist if joint arrangements are in place nor if there is a separate basis of significant control. Spreading the right to appoint or remove a majority of the board across a group of persons collectively, so that no one person can do so without collaborating with someone else, may also help but with same caveats. As above, there is also scope to avoid counting indirect shareholding interests where held through a trust or firm rather than a legal entity.

What information must be included on the PSC register?

Once confirmed, PSC details must be included on the register and anyone inspecting the register must be informed of the most recent date of any alterations and whether there are further alterations to make. For individuals, details include: name, usual country of residence, nationality and date of birth. For relevant legal entities, they include: name, registered office, legal form and law under which it was formed. Non-statutory guidance sets out specimen wording to include on the register for each PSC condition and for alternative scenarios which might apply, as well as examples of notices which the company may be required to give to PSCs and others in respect of its PSC register. For PSCs who are individuals, there is a protection regime against disclosure of personal information to third parties in certain circumstances where there is a risk of violence or intimidation.

What are the sanctions for non-compliance with these rules?

Companies and directors who fail to comply will commit an offence (punishable by imprisonment or fine). If a registrable person fails to comply with the disclosure obligations, the company can serve a warning notice that it intends to follow-up with a restrictions notice. A restrictions notice can be served one month later if the original notice has still not been complied with. This means that any transfers of those shares are void, no rights may be exercised in respect of them and the company may not pay any sums due on them except in a liquidation.

The new rules are intricate and the analysis will be fact-specific. The following flowchart below may be helpful as a starting-point for identifying the requirements.

Flowchart to identify PSC registration requirements

Is a PSC condition met?

(i)
More than 25% shares

(ii)
More than 25% voting rights

(iii)
Right appoint/remove majority board

(iv)
SIOC over company

(v)
SIOC over trust or firm meeting a PSC condition

Who holds the shares/rights (directly or indirectly) or meets an SIOC PSC condition?

1
Individual (including governments)?
If not, go to box 2

2
Legal entity which qualifies as an RLE?
If not, go to box 3

3
Legal entity which does *not* qualify as an RLE (e.g. overseas unlisted)?
If so, look through it to identify any individuals/RLEs behind it who are PSCs with majority stake in it. If none, go to box 4

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Trustees or partners?
Consider...

If yes

Individual registrable unless:
(a) Only holds through majority stake in legal entity/ies which include an RLE
(b) Excepted role & no separate basis SIOC
(c) Other exception e.g. rights controlled by someone else who is registrable instead

If yes

RLE registrable unless:
(a) Only holds through majority stake in legal entity/ies which include an RLE
(b) Excepted role & no separate basis SIOC
(c) Other exception e.g. rights controlled by someone else who is registrable instead

If yes

Individuals or RLEs in question registrable unless:
(a) Only hold through majority stake in legal entity/ies which include an RLE
(b) Excepted role & no separate basis SIOC
(c) Other exception e.g. rights controlled by someone else who is registrable instead

If trustees hold shares, go to box 1 for trustees who are individuals and boxes 2 or 3 for legal entities – usually trustees registrable

Do trustees exercise SIOC over company?
If yes, registrable

Does an individual exercise SIOC over trust? If yes, registrable

Limited partners not registrable under 1st 3 PSC conditions if not involved in management

General partner in limited partnership and/or individuals or RLEs behind general partner who are PSCs usually registrable

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