

PSC Regime

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Unintended consequences in the search for transparency?

Changes to the Companies Act 2006 as a result of the Small Business, Enterprise and Employment Act 2015 are intended to increase transparency over the ownership and control of UK companies and LLPs¹ from early 2016 by requiring many of them to keep a register of people with significant control over them (known as a “PSC register”). This Insight considers whether (intentionally or unintentionally) lenders to borrower groups which include, or may in the future include, a UK company, will be required to be listed in the PSC register and if so, what the potential consequences of this are.

The legislation governing the requirements to maintain a PSC register and related statutory and non-statutory guidance is detailed and complex. It also leaves a lot of scope for interpretation and if interpreted incorrectly could have significant consequences. Furthermore, there is guidance which has still yet to be issued and which may impact the analysis below. White & Case are available to discuss with you in more detail should you require further assistance.

What are the requirements for companies?

As of 6 April 2016 most UK companies will be required to keep a PSC register and as of 30 June 2016 the majority of information contained in the PSC register will be made public via Companies House through a company search².

The relevant types of persons required to be included in the PSC register are:

- individuals (whether or not resident or domiciled in the UK) with significant control over the company, i.e. individuals that (either alone or with joint holders) satisfy at least one of five possible conditions which are set out in more detail below (“**PSC individuals**”); and
- a legal entity which satisfies at least one of five possible conditions set out in more detail below and which (i) maintains its own PSC register, or (ii) is a DTR 5 issuer³, or (iii) has its voting shares admitted to trading on a regulated market in the European Economic Area (other than the UK) or on specified markets in Switzerland, the USA, Japan or Israel (a “**relevant legal entity**” or “**RLE**”).

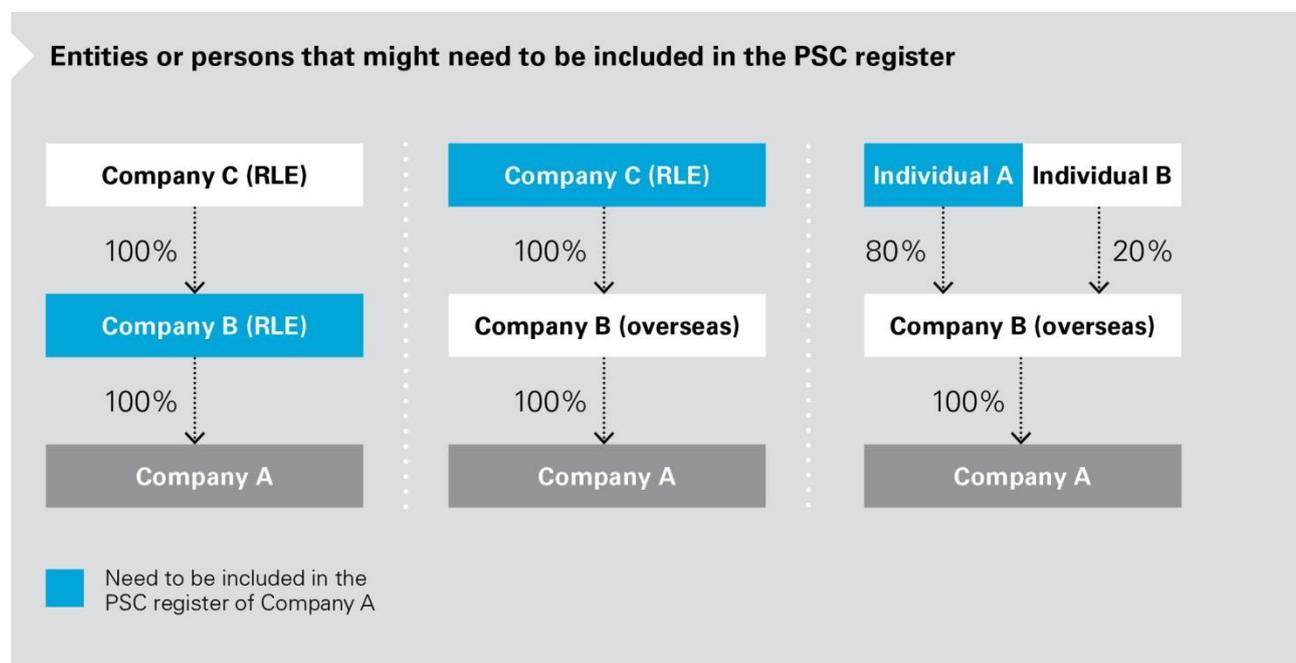
PSC individuals and relevant legal entities (together, “PSCs”) will only be disclosable under the new regime if they are registrable. The analysis for determining whether a person or entity is a PSC and is registrable is fact specific and requires reference to the detailed legislation and guidance. However, as a general rule, the first

¹ This Insight focusses on the provisions applicable to companies but the rules apply to LLPs in broadly the same way.

² An individual’s residential address and date of birth will not be accessible to the public through Companies House.

³ A DTR 5 issuer is a company which is subject to Chapter 5 of the Financial Conduct Authority’s Disclosure and Transparency Rules.

PSC individual or RLE in the chain of ownership (starting from the company's immediate holding company upwards and only to the extent held through a chain of majority stakes) will be the PSC individual or RLE that needs to be included in the PSC register. Set out below are some examples of which entities or persons might need to be included in the PSC register of Company A (a UK company) depending on its ownership structure:



These examples highlight the need for a company to look through the chain of ownership for the purposes of complying with its PSC register obligations.

What are the requirements for PSCs?

It is not only companies which are subject to obligations under the legislation. PSCs are themselves subject to the following duties:

Failure to respond: A company may be required to serve notice on a person or entity the company knows, or has reasonable cause to believe, is a PSC, for the purposes of registering them. A person or entity on whom that notice is served must respond to such notice within one month from the date of the notice. Failure to do so is an offence, punishable by imprisonment or fine unless that person can prove the information request was vexatious or frivolous.

Failure to notify: There is also a separate duty on a registrable person or entity to provide information to the company if that person or entity knows or ought reasonably to know that they are registrable, their particulars are not on the PSC register, they have not received a notice from the company to provide particulars and this has persisted for at least a month. In these circumstances the person must notify the company of its status as a PSC, state the date on which it acquired that status and give the company the particulars required for it to be included on the PSC register with one month of all of the above conditions being met. Again, breach of this requirement is an offence, punishable by imprisonment or fine.

Duty to keep information up-to-date: The obligation on a person or entity is ongoing such that it is obliged to notify a company of a 'relevant change' if it knows or ought to reasonably to have known of the change, the PSC register has not been updated to reflect the change and it has not received notice from the company within one month of the date of the change. Breach of this requirement is an offence, punishable by imprisonment or fine.

Makes or recklessly makes a false statement: If a person or entity, in purported compliance with its obligations above, makes a false statement that it knows to be false in a 'material particular' or recklessly makes a statement that is false in a 'material particular' it will also be guilty of an offence, punishable by imprisonment or fine.

When might a lender be considered a person with significant control?

To determine when a lender may be required to be listed in the PSC register you need to consider in the first instance whether conditions one to three in the below list apply, and, if none of those applies, only then whether the fourth or fifth conditions apply.

Condition 1 – the individual holds, directly or indirectly, more than 25% of the shares in the company

If a lender has taken a shareholding stake of more than 25% of the shares of a UK company (directly or indirectly) then it (or its owners) may need to be included on the PSC register either as a relevant legal entity or as a PSC individual via a look through the chain of ownership. This condition may⁴ also apply where a lender has taken security over the shares of a UK company. This would be the case even if the lender had registered the shares in the name of a nominee.

Condition 2 – the individual holds, directly or indirectly, more than 25% of the voting rights

If a lender holds more than 25% of the voting rights of a UK company (directly or indirectly) then it may need to be included on the PSC register either as a relevant legal entity or as a PSC individual via a look through the chain of ownership. This condition may⁵ also apply where a lender has taken security over the shares of a UK company pursuant to which it has security over rights attached to the shares. If the lender holds warrants (in its capacity as lender or otherwise) and is treated as a shareholder for voting rights (i.e. is granted equivalent rights by contract) it may satisfy this condition if the 25% threshold test is met.

Condition 3 – the individual holds the right, directly or indirectly, to appoint or remove a majority of the board

It is unusual for a lender, in such capacity, to have the right to appoint or remove directors with a majority of the voting rights of the board. Even if a lender were to have the right to appoint a single director this will not, on its own, trigger the requirement for the lender to be registered on the PSC register (assuming this would not amount to a voting majority). However, detailed examination needs to be made of any such rights or voting rights attached to shares or any warrants held by the lender which can affect decisions of the board even where such rights might only be exercisable in certain circumstances if those circumstances are within the control of the holder of those rights.

Condition 4 – the individual has the right to exercise, or actually exercises, significant influence or control over the company

This is the most problematic of all of the conditions. Draft statutory guidance has been published to assist UK companies to determine in which scenarios a person might have significant influence or control over the company under this condition.

⁴ If the person which has granted the security retains control over rights attached to the shares except where the lender is permitted to exercise such rights for the purpose 'of preserving the value of the security, or of realising it' that person will continue to be considered as the holder of the shares and not the lender. This is also the case where the lender can take control of the rights attached to the shares but must exercise them in the interests of the owner other than where the lender exercises the rights for the purpose 'of preserving the value of the security, or of realising it'. Therefore careful drafting of any agreements in respect of legal or equitable security over shares is required.

⁵ See footnote above.

The guidance includes the following general statements as to the terminology:

“Significant influence” and “control” are alternatives	Where a person can direct the activities of a company, this would be indicative of “control”
Where a person can ensure that a company generally adopts the activities which they desire, this would be indicative of “significant influence”	The “control” and “significant influence” do not have to be exercised by a person with a view to gaining economic benefits from the policies or activities of the company

The guidance does not provide an exhaustive list of what constitutes rights to exercise, or the actual exercise of, “significant influence or control” but provides examples of what might constitute significant influence or control, including where a person has absolute decision or veto rights over decisions related to the running of the business of the company. Many loan agreements will include covenants (such as (i) an agent’s approval right on the borrower’s budget (subject to a reasonableness caveat), (ii) restrictions on any changes to the business of the borrower and (iii) restrictions on additional borrowing from lenders (subject to exceptions)) that could arguably be described as types of the absolute decision rights or veto right examples listed in the guidance provided they can be exercised by a single lender and subject to the ‘excepted role’ carve-out described below. In tandem to any rights under the loan agreement a lender may have rights attached to warrants that are granted by contract (for example, under a shareholders’ agreement to which they are a party) pursuant to which it may have decision making powers or voting rights similar to those examples set out in the guidance and as such those rights might constitute significant influence or control. The rights attached to any such warrants would need to be examined on a case-by-case basis to determine whether they, on their own or in combination with a lender’s rights under a loan agreement and/or any other rights, could trigger this condition.

The guidance requires all relationships that a person has with the company, or other individuals with responsibility for managing the company, to be taken into account to determine the cumulative effect of those relationships. The guidance provides that significant influence or control would have been exercised if a person is significantly involved in the management and direction of the company (for example, someone who is regularly consulted on board decisions and whose views influence decisions made by the board).

There are certain roles which are ‘excepted roles’ i.e. roles and relationships which a person may have with a company which would not, on their own, result in that person have the right to exercise or actually exercising, significant influence or control. One of these roles includes that of lender. However, where that role as lender contains elements which exceed the role as it is generally understood or is one of several opportunities which that person has to exercise significant influence or control it will not be an excepted role. For example, if a lender has majority voting rights under a loan agreement together with a number of other rights (whether or not in its capacity as lender) such as a right to appoint a board observer, warrant rights or a nominal shareholding then the question arises as to whether this would exceed the lender role as it is ‘generally understood’. The totality of all of these rights could also further strengthen the argument that the lender does have a right to exercise significant influence or control.

Ultimately, there is not a robust and clear answer to the question of whether a lending relationship under a typical loan agreement, with or without warrants and with or without board rights or any other rights, would trigger the requirement to be registered as a PSC.

Condition 5 – the individual has the right to exercise, or actually exercises, significant influence or control over a trust or firm which itself satisfies at least one of the above conditions

It is unusual for a lender to have rights over a trust or firm in a financing structure so this condition is unlikely to apply. However, if the lender is a trust or a firm without legal personality but would meet any of conditions one to four if it were an individual then any individuals or entities which control the trust or firm may need to be listed on the PSC register.

Share restrictions

In addition to the possible offences identified above, if a registrable person fails to comply with its disclosure obligations, this will be noted on the PSC register and the company can serve a warning notice on the registrable person stating that it intends to follow-up with a restrictions notice. The effect of a restrictions notice is that, among other things, any transfers of the relevant 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. A company may also apply to court to sell a restricted interest if the restrictions are not encouraging the PSC to comply with their information obligations and the restrictions are affecting the operations of the company.

Conclusion

Save for the simplest of ownership structures, uncommon to most leveraged finance transactions, consideration will need to be given as to the impact of the PSC register on disclosure requirements of a UK company in the group. For lenders, it is not simply a concern of having the information being made public but the burden on companies and lenders alike to determine whether their financing structures result in lenders being PSCs and the potential ramifications if a lender does not notify a company that it is a registrable person.

Critically, the changes apply to existing investments, as well as to future investments. The key point at this stage is to be aware of the changes, to engage with any borrower groups that have a UK company to ensure they will be in compliance with their obligations and to consider:

- the impact on any existing financings;
- the need for amendments to loan agreements or shareholder, investment or other agreements in respect of warrants (or inclusion of obligations in new loan agreements and/or warrant agreements, such as delivery of the PSC register at closing and keeping it up-to-date as an ongoing obligation);
- structuring transactions in a different way if there are any concerns.

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