

The PSC Register Regime: Consequences for banking transactions

Since the 6th April 2016, all UK incorporated companies (that are not exempt) and LLPs are required to keep a register of individuals and/or certain legal entities with "significant control" over them.

At first sight, this may appear to be no more than another corporate information requirement like keeping a register of members and a register of directors. However, from a banking perspective, the PSC register regime goes much further than this.

In particular, security may not be able to be taken or enforced over shares in a company with a PSC register if the PSC register regime has not been complied with and a restrictions notice has been issued. Finance parties may also need to be registered on a company's PSC register, as well as actively provide information on their interests in the company, unless they fall within specific exemptions.

This briefing provides a high level overview of what those operating in the syndicated loans market need to know about the PSC register regime and outlines the consequences of the regime for banking transactions.

What is the PSC register regime?

New Part 21A of the Companies Act 2006, which came into force on 6 April 2016, contains a requirement on all UK companies that are not exempt (broadly unlisted companies) to keep a register of individuals and/or certain legal entities with "significant control" over them.

The PSC register must be updated on an ongoing basis and will be searchable either at the company's registered office or, from 30 June 2016, at Companies House in the case of a private company which has elected to keep its PSC register there.

The PSC information will also need to be filed by companies at Companies House when making their confirmation statement (which is replacing

Key issues

- Security over shares may not be able to be taken or enforced if a restrictions notice is in place.
- A security agent/lenders may be subject to the PSC register regime unless they fit within a carve-out for security over shares.
- Lenders may be subject to the PSC register regime unless they fit within a carve-out for financial agreements.
- Failure to comply with obligations under the PSC register regime is a criminal offence.

the annual return) from 30 June 2016.

There is an equivalent requirement on LLPs to maintain PSC registers, however this briefing focuses on the requirement for companies. It also focuses on the registration requirements for legal entities, which apply equally to individuals.

What constitutes a legal entity with "significant control"?

A legal entity has "significant control" over a company where it satisfies one or more of five conditions (see box).

5 Conditions for control

Any one or more of:

- Condition 1 – holds, directly or indirectly, more than 25% of the shares in the company.
- Condition 2 – holds, directly or indirectly, more than 25% of the voting rights in the company.
- Condition 3 – holds the right, directly or indirectly, to appoint or remove a majority of the board of directors of the company.
- Condition 4 – has the right to exercise or actually exercises, significant influence or control over the company.
- Condition 5 – has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm that is not a legal entity, which would itself satisfy any of conditions 1 to 4 in relation to the company if it were an individual.

Are all legal entities with "significant control" required to be registered on a company's PSC register?

No, not all legal entities that satisfy one or more of the five conditions in the box are required to be registered on a company's PSC register. A legal entity must also be a **relevant** legal entity (a "RLE") and be **registrable**.

To be a RLE, the legal entity must be **subject to its own disclosure requirements**, which means it:

- is required to keep a PSC register itself;
- is an issuer subject to Chapter 5 of the Disclosure Rules and Transparency Rules;
- has voting shares admitted to trading on a regulated market in an EEA State other than the UK; or
- has voting shares admitted to trading on certain markets in Israel, Japan, Switzerland or the USA.

Examples of legal entities which would not be RLEs are unlisted foreign companies and unlisted UK legal entities which are not subject to their own disclosure requirements (e.g. Scottish limited partnerships).

Broadly, a RLE is registrable if it is the first RLE in the company's ownership chain.

What are the consequences of failing to comply with the PSC register regime?

A company required to keep a PSC register has a number of obligations under the PSC register regime. For example, it must take reasonable steps to identify registrable RLEs, including by requesting information from any legal entity whom the company knows or has reasonable cause to believe to be a registrable RLE.

Registrable RLEs also have obligations under the PSC register regime to notify a company of their status, keep the company up to date on any changes and respond to requests for information from the company (the "**Information Obligations**").

Legal entities and RLEs which are not registrable are also obliged to respond to requests for information from the company.

Failure to comply with such obligations is a criminal offence which can lead to a **fine** or **imprisonment**. A **restrictions notice** can also be issued (see below).

Does the PSC register regime have any implications for banking transactions?

Yes, there are four areas of the PSC register regime which are of potential concern to banking transactions:

- the issue of a restrictions notice;
- the security agent/lenders meeting conditions 1, 2 and/or 3 and being subject to the PSC register regime;
- the lenders meeting condition 4 and being subject to the PSC register regime; and
- the lenders meeting condition 5 and being subject to the PSC register regime.

If a lender or security agent is subject to the PSC register regime, it will be registered on the company's PSC register and subject to the Information Obligations.

In our view, only the first area above is likely to be relevant in a typical banking transaction involving security over shares in a UK company with a PSC register. However, it is important to be aware of the other three areas should the features of a transaction differ.

Restrictions Notices

If a company makes a request for information from a legal entity with a **relevant interest**

(defined as any shares or voting rights in the company or the right to appoint or remove any member of the board of directors of the company) and it fails to respond to two such requests, the company may issue a restrictions notice on such legal entity in respect of its relevant interest.

A restrictions notice has the effect of freezing the legal entity's relevant interest (i.e. its shares, voting rights or board appointment rights) so that any sale or transfer of it, or any agreement to sell or transfer it, is void and no rights are exercisable in respect of the frozen interest.

The restrictions notice can be withdrawn and the freeze lifted by the company - if the request for information is satisfied - or by order of the Court.

This aspect of the PSC register regime has potential implications for banking transactions where there is security over shares and a restrictions notice has been issued to the chargor in respect of those shares. Such a restrictions notice could affect whether the security can be given, whether the security can be enforced and whether voting rights can be exercised.

Further, where the security is intended to constitute a "security financial collateral arrangement" pursuant to the Financial Collateral (No.2)

Regulations 2003, the issue of a restrictions notice could frustrate one of the purposes of the legislation which is to enable the swift enforcement of security over financial collateral by removing the need for a Court order.

The issue of a restrictions notice is discretionary. When considering whether to issue a restrictions notice, the company is required to take into account its effect on the rights of third parties in respect of the relevant interest. This could potentially include the rights of the security agent as holder of security over the shares, however, this is not clear.

What measures can be taken to address the risk of a restrictions notice being issued or in place?

Various measures can be taken including:

- undertaking a search of the company's PSC register before share security is taken, before it is enforced and before voting or other rights are exercised in relation to the shares to ascertain whether a restrictions notice is in place;
- having conditions precedent requiring certificates from the chargor and the company that no restrictions notices

- have been received or issued;
- having a representation from the chargor that no restrictions notice has been issued to it;
- having an undertaking from the chargor that it will comply with all notices it receives pursuant to the PSC register regime and provide the security agent with copies of any such notices; and
- having an undertaking from the company that it will not issue any restrictions notices unless required by law.

Conditions 1, 2 and 3 and the security agent/lenders

The conditions for control which pertain to holding more than 25% of the shares or 25% of the voting rights in a company or board appointment rights could be met by a security agent/lenders in the context of a legal or equitable share charge where: (a) the security agent is or becomes the registered holder of the shares; and/or (b) the security agent/lenders acquire voting rights (in each case at the outset or on enforcement of the share security). If the security agent/lenders hold voting rights, this may also give them board appointment rights.

However, there is a **specific carve-out** from the PSC register regime for **rights attached to shares held by way of security** where, except from exercising them to preserve the value of the security or realise it, the rights are only exercisable in the chargor's interests.

While the carve-out appears *generally* to exempt the security agent/lenders from being subject to the PSC register regime by virtue of any rights they acquire in relation to shares held by way of security, the terms of share security documents should still be reviewed carefully to ensure that the carve-out will apply.

Where the security agent becomes the registered holder of the shares (e.g. a legal mortgage is taken or an equitable charge is enforced resulting in the security agent becoming the registered holder), it is unlikely that the carve-out would apply because it applies where *rights* attached to shares are held by the security agent, as opposed to where the shares themselves are held by the security agent.

Condition 4 and the lenders

There is statutory guidance on the meaning of "significant influence or control", both of which are defined very broadly. The statutory guidance also

contains a non-exhaustive list of what might constitute a right to exercise significant influence or control over a company, which includes absolute decision rights over matters related to the business of the company such as changing the nature of the company's business, adopting the business plan and changing the company's constitution. This could capture lenders under facilities agreements containing a standard set of representations and undertakings relating to the borrowers/guarantors and their businesses.

However, the statutory guidance includes **carve-outs** and sets out a non-exhaustive list of excepted roles and relationships that would not, *in the normal course*, result in the legal entity being considered to be exercising significant influence or control. These include where the legal entity deals with the company under a third party commercial or financial agreement, such as a lender, supplier or customer.

Accordingly, lenders under an LMA style facilities agreement would not ordinarily fall under condition 4. However, if the lender's role or relationship differs in material respects or contains significantly different features from how the role or relationship is generally understood or if the role or relationship forms one of

several opportunities which the lender has to exercise significant influence or control over the company, the carve-out for lenders may not apply.

Each transaction must therefore be analysed on its facts. It is also important to note that the right to exercise significant influence or control does not actually need to be exercised to come within the parameters of this condition. Just having the right is sufficient.

Condition 5, the security agent and the lenders

Condition 5 applies where there is a trust arrangement, which could include a security trust. It contains a 2 stage test, which considers in the first instance whether the trustee(s) meet any of conditions 1 to 4 in relation to the company, then, if the trustee(s) do so, whether anyone has the right to exercise, or actually exercises, significant influence or control over the activities of the trust.

If the security agent meets any of conditions 1 to 4 and the carve-out does not apply, as a trustee, the first test is satisfied and it falls to consider the second test.

The statutory guidance on the meaning of "significant influence or control" also contains a non-exhaustive list of what might constitute a right to exercise significant

influence or control over a trust, as well as examples of where a person actually exercises significant influence or control over the trust. The examples include where a person issues instructions, which are generally followed, as to the activities of the trust, such as a beneficiary. This could capture lenders instructing the security agent (e.g. to enforce security) pursuant to security trust provisions. While the statutory guidance contains carve-outs and sets out a non-exhaustive list of excepted roles and relationships, these do not apply to beneficiaries of the trust.

Accordingly, where the security agent satisfies the first test, the lenders are likely to satisfy the second test and could be subject to the PSC regime pursuant to condition 5, by virtue of directing the security trust.

Conclusion

In view of its potential consequences for banking transactions, particularly where security is taken over shares in a UK company that is required to keep a PSC register, the PSC register regime should be considered carefully.

Where security is taken over shares in such a UK company, due diligence should be carried out on the PSC register and contractual comfort sought

from the company in respect of the issue of restrictions notices.

It may be the case that the lenders or security agent will not be a RLE e.g. they are unlisted overseas entities, in which case they will not be subject to the PSC register regime. They will still be obliged though to respond to any information requests from the company as to whether they are a registrable RLE, with the attendant consequences for failure to respond. The company will also be required to look through their chain of ownership until a registrable RLE is found or the company has established that there are no such registrable RLEs.

Where the lenders or security agent could be RLEs, the representations and undertakings in the facilities agreement and the terms of the share security document should be reviewed carefully to ensure that the carve-outs would apply.

If a lender or security agent is subject to the PSC regime, it will be registered on the company's PSC register and subject to the Information Obligations. While the Information Obligations may not appear to be very onerous, failure to comply with them is a criminal offence, punishable by a fine or imprisonment.

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