SHEARMAN & STERLING LLP

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The New PSC Regime

The UK is introducing new beneficial ownership disclosure rules, which will require UK companies and LLPs to create and maintain a new statutory register of people with significant control over them (a PSC register). This note sets out the main features and requirements of the new regime.

Introduction

From 6 April 2016, subject to certain exemptions mentioned below, UK companies, limited liability partnerships ("LLPs") and societates europaeae ("European Companies" or "SEs") will have to establish and maintain a new statutory register of persons with significant control over them ("PSCs" and the "PSC register"). This register will be open to public inspection. From 30 June 2016, they will also have to file the information in their PSC registers with Companies House where it will be publicly available. These new rules implement a commitment by the UK government to increase transparency of corporate ownership for various purposes.

The principles behind this new "PSC regime" are relatively straightforward, but the detailed legal rules setting out the regime - particularly as they apply to complex corporate structures, as opposed to wholly-owned group structures - are quite complex.

Although the rules are primarily designed to require the disclosure of beneficial ownership or control by individuals of private or unlisted UK companies, they will still be relevant to listed groups of companies with UK subsidiaries. These UK subsidiaries will be required to keep a PSC register and include in it details of their parent company as their significant owner or controller (as explained below).

PSCs and RLEs

A company's PSC register must always disclose whether or not the company has any PSCs, and by definition these people will always be individuals (i.e. natural persons) who have certain interests in or a level of control over the company, whether held directly or indirectly.

However, in certain cases mentioned below (see "*Holdings or Interests Held by Legal Entities Which are RLEs*" below), where: (i) an individual has "significant control" over a company indirectly through a chain of companies, or (ii) there is no such individual in relation to the company required to keep the PSC register (e.g. in the case of listed group of companies with no controlling shareholder), instead of registering an individual as a PSC, the company may be required to register a legal entity (a "Relevant Legal Entity" or "RLE") which has significant control over the company, whether directly or indirectly. This will be the case where the interest or control held by the legal entity would have made it registrable as a PSC if it had been an individual and where that entity is itself subject to certain public disclosure requirements with respect to its own beneficial owners or controllers (including, if it is a UK incorporated entity, through having to keep its own PSC register).

The idea here is that anyone searching to find out which individuals may ultimately be in a position to exercise significant control over the company with the PSC register will be able to pursue their searches by looking at the public disclosures made by an RLE registered on the PSC register.

Key principles underlying the PSC regime (described in the rest of this note) therefore include:

- when a person is to be taken to have "significant influence or control" over a company,
- when a person is to be taken to have an "indirect" interest in a company, and
- which legal entities are to be treated as RLEs and so potentially registrable on a PSC register.

Who is Covered by the Regime?

All UK companies, LLPs and SEs. Exempted UK companies, which do not have to keep a PSC register themselves but, as mentioned above, might in some cases find themselves having to be entered on another company's PSC register as an RLE, are those subject to similar ownership disclosure requirements under certain listing regimes – i.e. UK companies with voting shares admitted to trading on: (i) regulated markets in the UK (e.g. the London Stock Exchange's Main Market) or AIM, (ii) other EEA regulated markets or (iii) certain specified exchanges in the US (including NYSE and NASDAQ), Japan, Switzerland and Israel. Even though these "listed" UK companies will not need to keep a PSC register themselves, their unlisted UK subsidiaries will still have to maintain their own PSC registers.

The new law does not currently apply to other UK entities such as limited partnerships or charitable incorporated organisations. It also does not require any non-UK incorporated or registered entities to keep a PSC register, even if they have a presence or branch in the UK.

In general, the rules are the same for companies (including SEs) and LLPs, save where expressly provided otherwise. By way of background, SEs are companies that are formed under an EU Regulation and are treated as public companies in the EU member state in which they are registered and can move their domicile or place of registration between member states.

Who are Persons with Significant Control (PSCs)?

A PSC is an individual who meets at least one of the following conditions (the PSC conditions) in relation to a company (the conditions are different in relation to LLPs - see "*What About Interests Held in LLPs*" below):

- holds, directly or indirectly, more than 25% of the shares,
- holds, directly or indirectly, more than 25% of the voting rights,
- holds, directly or indirectly, the right to appoint or remove directors holding a majority of the votes that can be cast at board meetings,
- has the right to exercise, or actually exercises, *significant influence or control* over the company (the fourth PSC condition), or
- has the right to exercise, or actually exercises, *significant influence or control* over the activities of a trust or firm which is not a legal entity and which meets any of the above mentioned conditions (the fifth PSC condition).

PSCs also include corporations sole (i.e. where the function of an office sits with a particular person), governments or government departments of any country or territory, international organisations whose members include two or more countries or territories or their governments and local authorities or local government bodies in the UK or elsewhere, in each case which meet any one of the PSC conditions.

People who are party to "joint arrangements" are treated as each holding their combined shares or rights. "Joint arrangements" is given a very broad meaning under the rules and includes understandings that are not legally enforceable and conventions, customs and practices of any kind. They must nevertheless have some degree of "stability". Needless to say, companies (and potential PSCs or RLEs) could in particular cases find it very difficult to determine whether there are any "joint arrangements" in existence that could require interests to be combined for the purposes of the PSC conditions and registration on the PSC register.

What is Significant Influence and Control?

This catch-all phrase, as used in the fourth and fifth PSC conditions, is designed to catch as PSCs individuals who have a controlling interest or influence in the company but who, because of the way in which their corporate ownership is structured, fall outside of the first three PSC conditions and so might otherwise not be regarded as PSCs. Statutory guidance is being issued to help with interpreting this phrase (the guidance currently exists in draft form awaiting approval by Parliament through the "negative procedure" (i.e. no objections to the guidance being recorded)). There is separate draft guidance for the meaning of this phrase in relation to LLPs. Links to this guidance and other relevant materials in relation to the PSC regime are provided at the end of this note (see "*Source of the Rules*" below). The guidance provides a statement of principles and a number of examples, to assist in understanding the meaning of the phrase, all of which are stated to be indicative rather than exhaustive, and which ultimately require each situation to be assessed according to its particular circumstances. Significantly:

- if a person meets one of the first three PSC conditions, it is not necessary to determine whether the person also satisfies the fourth PSC condition,
- control and significant influence are alternatives - a person who can direct the activities of a company, trust or firm likely has control over it, whereas a person who can ensure that a company, trust or firm generally adopts certain activities likely has significant influence over it,
- control and significant influence do not necessarily have to be exercised with a view to gaining an economic benefit,
- a right to exercise significant influence or control would likely:
    - be inferred from a person having: absolute decision or veto rights regarding the running of the business of the company (e.g. adopting or changing the business plan), or absolute veto rights over the appointment of directors who hold a majority of the voting rights at meetings of the board, and
    - not be inferred from a person having veto rights regarding certain fundamental matters for the purpose of protecting a minority interest (e.g. changing the constitution, anti-dilution protection or on a winding up), or having on a temporary basis absolute decision or veto rights solely due to being the prospective purchaser of the company,
- the actual exercise of significant influence and control:
    - should be assessed with reference to all relationships the person has with the company or other individuals who have responsibility for its management to determine whether the cumulative effect of such relationships enables the person actually to exercise significant influence and control,

- would likely exist if the person is significantly involved in the management and direction of the company (e.g. a person who is not a director, but regularly or consistently directs or influences board decisions such as a shadow director), and
- would likely exist if the person's recommendations are always or almost always followed by shareholders who hold the majority of the voting rights when deciding how to vote (e.g. a company founder),

- there is a limited safe harbour for people who have certain roles in, and relationships with, the company. They are not deemed to satisfy the fourth PSC condition solely because of their role or relationship. These include professional advisors (e.g. lawyers and accountants), third party commercial or financial counterparties (e.g. suppliers), functionaries appointed by law (e.g. regulators or liquidators), employees acting in the course of their employment, directors (including a managing or sole director or director with a casting vote) and employee representatives. However, it is not a full safe harbour as these people can still be seen as having significant influence or control over a company if their role or relationship has some unusual features so that it materially differs from what it is generally understood, or it forms one of several opportunities which the person has to exercise significant influence or control.

What About Indirect Holdings by PSCs and Companies Owned or Controlled by Other Legal Entities?

Indirect Holdings

If a PSC's shares or rights in a company are all held indirectly through one or more legal entities (whether UK or foreign), the PSC will only have to be considered for registration in the PSC register if two conditions are satisfied:

- the PSC has control over such entity(ies) in the sense of holding a "majority stake" (see Box 1) in them, directly or through intermediate "majority stakes" held in entities forming a legal chain of ownership which ends with the UK company keeping the PSC register. Where, in the legal chain of ownership, only a minority stake is held, the link between the ultimate PSC and the UK company keeping the PSC register will be broken and the PSC will not have to be entered on the PSC register, and
- none of those legal entities qualifies as an RLE (see Box 2).

Box 1

A majority stake in a company means:

- having a majority of the voting rights,
- being a member with the right to appoint or remove the majority of the board holding a majority of the votes that can be cast at board meetings,
- being a member and controlling (alone or with others) a majority of the voting rights, or
- being entitled to exercise or actually exercising dominant influence.

Indirect and Direct Holdings

An individual may have both a direct and indirect interest in a UK company keeping a PSC register. In that case, both interests will need to be aggregated to determine whether (and the extent to which) the individual is a registrable PSC in relation to the UK company. The same aggregation of interests may be required in the case of RLEs which have both direct and indirect interests in a UK company keeping a PSC register.

Holdings or Interests Held by Legal Entities Which are RLEs

An individual does not have to be registered as a PSC in a company's PSC register if the individual's "controlling" position or interest (see "*What About Indirect Holdings by PSCs and Companies Owned or Controlled by Other Legal Entities?"*) in the company is held indirectly through one or more legal entities, at least one of which is an RLE (see Box 2). In this case, the company must reflect in its PSC register only the first RLE nearest to it in the chain.

Any companies in the chain between the RLE and the company keeping a PSC register are ignored for registration purposes, as are any companies in the chain sitting above the RLE, as well as, ultimately, any individuals with significant control over those companies (assuming they do not also hold direct interests which qualify them as PSCs in relation to the company keeping the PSC register).

As mentioned above (under "*Indirect Holdings*"), if one or more legal entities in the chain does not have a majority stake in the entity below it in the chain, the "indirect ownership" chain will be broken, and no RLE or PSC will be registrable on the PSC register with respect to that particular "chain of ownership."

Listed Groups of Companies with UK Subsidiaries

As indicated at the beginning of this note, where the UK company keeping a PSC register is a subsidiary in a group headed by a parent whose voting shares are listed or traded on any of the markets referred to in Box 2, assuming there are no individuals exercising significant control directly over the UK subsidiary, that subsidiary will generally be required to enter in its PSC register as an RLE, either its listed group parent or, if there is intermediate holding company closer to it that qualifies as an RLE (e.g. a UK intermediate parent subject to the PSC regime itself) that intermediate holding company.

The example diagrams in the Annex illustrate how this all works.

Box 2

An RLE is a legal entity (UK or foreign) which:

- if it had been an individual would have satisfied one of the PSC conditions, and
- is either: (i) a UK company subject to the PSC regime or to ownership disclosure requirements through being listed or traded on UK or other EEA regulated markets or AIM, or the US, Japanese, Swiss or Israeli exchanges mentioned above (see "*Who is Covered by the Regime?"* above), or (ii) a non-UK company subject to ownership disclosure requirements through being listed on UK or other EEA regulated markets, or the US, Japanese, Swiss or Israeli exchanges mentioned above.

What About Interests Held in LLPs?

As the nature of interests held in LLPs is different from interests held in companies, a PSC in relation to an LLP is an individual who meets at least one of the following conditions:

- holds, directly or indirectly, the express right to share in more than 25% of any surplus assets of the LLP on a winding up (and if such rights are not express, each member is treated as holding the right to an equal share),
- holds, directly or indirectly, more than 25% of the rights to vote on matters to be decided by the votes of members,
- holds, directly or indirectly, the right to appoint or remove the majority of persons entitled to take part in its management,

- has the right to exercise, or actually exercises, significant influence or control over it, or
- has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm which is not a legal entity, and which meets any of the above mentioned conditions.

What Must be Done by Whom and are There Penalties?

A company (and an LLP) must take ‘reasonable steps’ to establish if there are any registrable PSCs and RLEs in relation to it and, if there are, to identify them. It then has to enter certain prescribed information with respect to the existence (or not) of any PSC or RLE in its PSC register, as well as certain prescribed information regarding any PSC or RLE (see *“Completing the PSC Register”* below). Reasonable steps are those a reasonable person would take if he or she had the same information as the company - it will include reviewing available existing information and documentation (e.g. articles of association, shareholders’ agreements and voting patterns). If there are gaps in the information, it must send a notice to any person it has reasonable cause to believe should be recorded on its PSC register. If it fails to take steps and issue notices when required, both the company and any of its officers (directors) who are in default will have committed a criminal offence, punishable by a fine and/or up to twelve months’ imprisonment. No notices need be sent if the company already knows that someone needs to be registered as a PSC or RLE and all the information about them that needs to be shown on the register has been confirmed.

Further, anyone who knows or ought reasonably to know that it is a registrable PSC or RLE in relation to a company or LLP, is not recorded in the company’s PSC register and who has not received a notice from the company, has a duty to notify the company within one month of these conditions being satisfied of the person’s status, failure of which also makes that person guilty of a criminal offence.

A company is given broad powers to facilitate compliance with the PSC regime. It can serve a notice on anyone it knows or has reasonable cause to believe can identify a registrable PSC or RLE, or who knows the identity of someone else likely to have that information requiring them to respond within a month - this notice could, for example, be sent to family members or to professional advisors such as lawyers. A company can also impose restrictions on the shares or interests of a person who did not provide information in response to a notice it sent them - such restrictions would effectively prevent the person from selling or receiving any payment in respect of the interest while the information requested by the company has not been provided, and this would be triggered by the issue of a restrictions notice which the company can issue after sending a warning notice. Aggrieved third parties can apply to court for a direction that certain acts may be taken despite the issue of a restriction notice if such restrictions unfairly affect their rights in relation to those interests.

Completing the PSC Register

A company’s PSC register can never be blank. It must state, using prescribed wording: (i) the nature of control exercised or held by a PSC or RLE, or (ii) that it knows or has reasonable cause to believe that there is no PSC or RLE, or (iii) that it has not identified a PSC that it nevertheless believes exists in relation to it, or (iv) that it has not had confirmed to it details of a PSC it has identified, or (v) that investigations are on-going with respect to finding out if it has any PSC or RLE.

The particulars of a PSC that must be recorded in the PSC register include the name, address, country of residence, nationality and the date on which the PSC became registrable. Information about a PSC must be complete and confirmed before being entered on the register. There is a protection regime under which individuals can, in certain limited circumstances, apply for some or all of their information to be withheld from the register.

Key Practical Steps for Companies to Consider Taking

Corporate groups with UK subsidiaries should ensure that any UK subsidiary required to keep a PSC register as of 6 April 2016 takes appropriate preparatory steps by identifying its registrable RLE (or any PSCs) and collating the information in the prescribed form that will have to be entered on its PSC register as from that date. In addition, going forward they will need to consider (i) preparing template PSC registers (with details of the prescribed wording that must be used for entries made in them) that can be distributed and used amongst UK subsidiaries, and (ii) creating a compliance program or checklist to comply with the PSC regime so that, for example, the PSC register can be promptly updated whenever it is necessary to reflect changes resulting from an internal re-organization of its UK subsidiaries.

Source of the Rules

The PSC register regime is set out in a new Part 21A of the Companies Act 2006 (inserted by section 81 and Schedule 3 of the Small Business, Enterprise and Employment Act 2015 which can be found here and here) , supplemented by more detailed provisions with respect to maintenance, etc. of the PSC register contained in The Register of People with Significant Control Regulations 2016 (found here), The Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016 (found here) and The European Public Limited-Liability Company (Register of People with Significant Control) Regulations 2016 (found here). The Government has also issued draft statutory guidance on the meaning of 'significant influence or control' in the context of companies and LLPs, as well as non-statutory guidance for companies, LLPs and SEs together with summary guidance (the most up to date versions of which can be found on the Government website here). In addition, the Government is intending to publish non-statutory guidance aimed at assisting PSCs in understanding their obligations under the new law.

Further Assistance

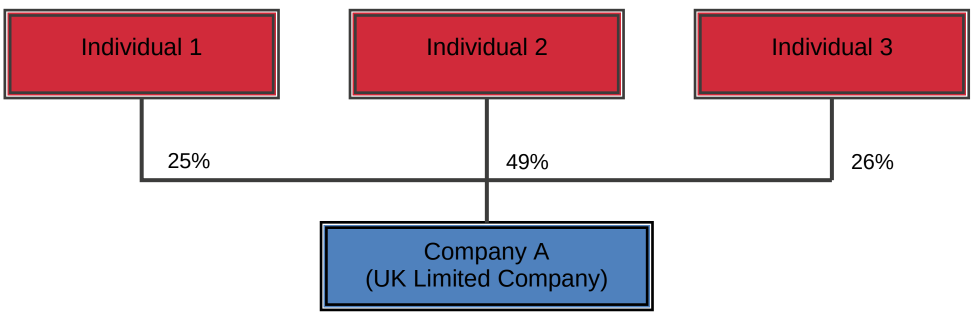
Should you have any queries or need further assistance do not hesitate to contact one of the persons listed at the end of this note.

Conclusion

Although the legislation and various pieces of guidance are complex and not clear in all cases, for most UK companies that are wholly owned subsidiaries of listed companies it should not be overly complicated to identify and record the necessary particulars for their PSC register.

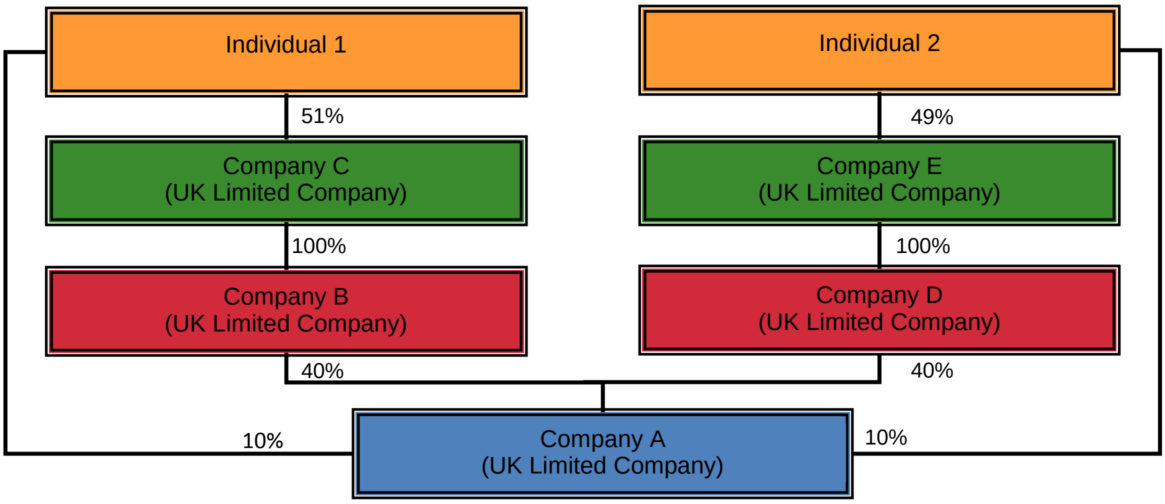
Annex

Example 1



Company A must record in its PSC register Individual 2 and Individual 3 as its PSCs, as they each hold more than 25% of its shares thereby meeting the first of the PSC conditions. Individual 1 is not a PSC as the individual does not meet any of the PSC conditions (assuming the individual does not have the right to exercise, or actually exercises, significant influence or control over Company A).

Example 2



Company A must record in its PSC register:

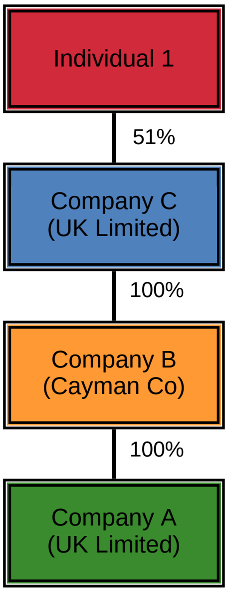
- Individual 1, who has both a direct and indirect interest in Company A (counted because of the majority stake held in Company C, which in turn has a majority stake (100%) in Company B) which, when aggregated, results in Individual 1 holding more than 25% of the shares in Company A,
- Company B, as it is the first RLE (having an interest of more than 25% in Company A) in the ownership chain nearest to it relating to Individual 1's interest, and
- Company D, as it is the first RLE (having an interest of more than 25% in Company A) in the ownership chain nearest to it relation to Individual 2's interest.

It would not record:

- Individual 2, who is not treated as having an indirect interest in Company A because the individual does not have a majority stake in Company E (and whose direct interest in Company A does not satisfy any of the first three PSC conditions, assuming the individual does not have the right to exercise or actually exercises significant influence or control),
- Company C, as it holds its entire indirect interest via a majority stake in Company B which is an RLE, or
- Company E, as it holds its entire indirect interest via a majority stake in Company D which is an RLE.

Companies B and D would record in their respective PSC registers Companies C and E as RLEs. Companies C and E would record in their respective PSC registers Individuals 1 and 2 as PSCs.

Example 3

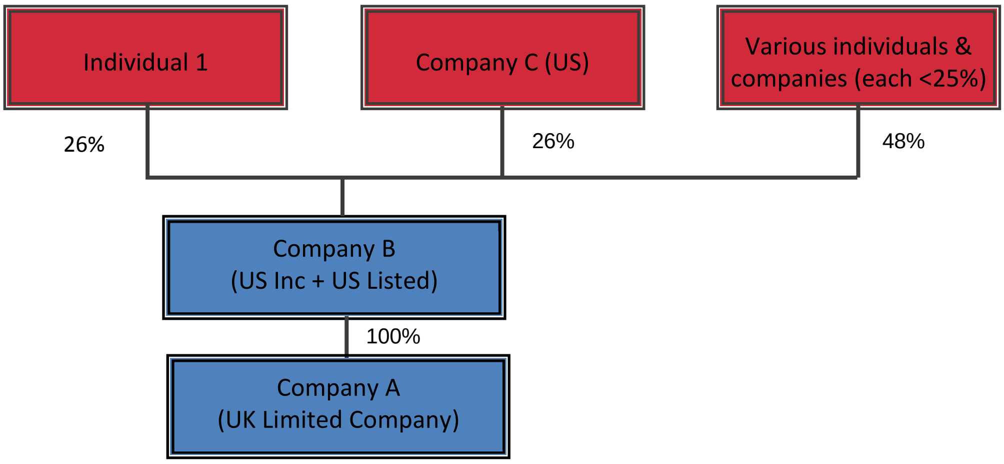


Company A would record in its PSC register Company C as an RLE, as it is the first RLE in the ownership chain nearest to it.

It would not record:

- Individual 1 because, even though the individual holds an indirect interest in Company A (counted, as Individual 1 has a majority stake in Company C which, in turn, holds a majority stake in Company B), that interest is held through a chain of legal entities at least one of whom (Company C) is an RLE, or
- Company B, as it is not an RLE (i.e. not subject to any beneficial ownership disclosure obligations).

Example 4



Company A must record in its PSC register Company B as an RLE. Individual 1 is not registrable in Company A's PSC register as a PSC because of the registration of Company B as an RLE. Company C and the other shareholders in Company B can be ignored for registration purposes for the same reason.

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