A&O SHEARMAN

New UK guidance for private equity firms on acquisitions and increases in control in PRA and FCA authorised firms

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The UK financial services regulators, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA), have recently set out their final policy on the assessment of acquisitions and increases in control of PRA and FCA authorised firms.

The guidance applies where a person seeks to acquire, or increase, control (either directly or indirectly) over a PRA or FCA authorised firm, becoming its "controller". Part XII of the Financial Services and Markets Act 2000 (FSMA) requires that a person who decides to acquire or increase control over a UK authorised firm must give the appropriate regulator notice in writing before making the acquisition.

The guidance applies from November 1, 2024.

The UK guidance replaces the EU guidelines on the assessment of acquisitions and increases of qualifying holdings in the financial sector (known as the 3L3 Guidelines), which established an EU-wide common understanding of the assessment criteria to be applied by the EU national competent authorities. In preparation for Brexit, the PRA and FCA had confirmed that they would continue to apply the 3L3 Guidelines post-Brexit as they had done before the UK left the EU. The new guidance follows a consultation paper (CP 25/23) published in November last year.

This will be of interest to private equity firms as it includes new guidance on limited partnership structures to help notice givers identify controllers within private equity acquisition structures.

Identifying controllers – application to Limited Partnership structures

In accordance with FSMA, a controller can include persons with a direct or indirect holding in an authorised firm which:

- Represents 10% or more of the shares or voting power; or

- Make it possible to exercise significant influence over the management of the authorised firm.

When determining whether an indirect holding results in a person being a controller or increasing control, FSMA includes in the definition of voting power, indirect holdings of "voting power" in the authorised firm. Potential acquirers will need to consider the controller definition (including the definition of shares and voting power) alongside the PRA and FCA guidelines.

The guidance notes that GPs typically have the power to exercise the voting rights associated with a Fund's interest in an undertaking or exercise dominant influence over the Fund. There may also be circumstances in which the Fund has arrangements with an investment manager to manage its portfolio. In such circumstances, consideration should be given to whether, depending upon the specific arrangements, this person(s) would be a controller.

Where there are different funds which individually have a holding below the 10% threshold, but share a common GP, consideration will also need to be given to whether the aggregation of voting rights of the Funds is attributable to the GP, meaning that the GP is an indirect controller.

The Fund may have several LPs investing, who may have no role in its management. In certain cases, however, some LPs may be considered a controller depending on their proportional interest.

Given the size, nature and complexity of private equity structures and similar types of fund structures, the PRA and the FCA expect that they will assess an authorised firm's controllers analysis for such structures on a case-by-case basis.

Significant influence

The PRA and FCA have also clarified what constitutes "significant influence" to make it clearer that, when determining if there is significant influence, it is not just a case of being on the board of an authorised firm or its parent, but the ability to direct or influence decisions made by the authorised firm's board that is crucial. Examples include (but are not limited to) making recommendations to the board which are almost always followed, additional rights granted by virtue of a contract entered into or a provision of the authorised firm's articles of association, other constitutional documents or shareholders' agreements or the existence of veto rights over material matters in relation to the running of the firm, such as changes to its business plan or strategy.

Additional information requests

The PRA and FCA welcome prior engagement for certain transactions due to their complexity. One such example of where the regulator may seek additional information is where a private equity or hedge fund is seeking to acquire or increase control to 20% or more of the authorised firm. In such cases, the regulator may seek the following additional information:

- A detailed description of the performance of previous acquisitions of financial institutions by the proposed acquirer (or any deemed controller in their ownership structure).
- Details of the proposed acquirer's investment policy and any restrictions on investment.
- The proposed acquirer's decision-making framework for investment decisions; and
- (Where the private equity or hedge fund is not authorised by the FCA), a detailed description of the proposed acquirer's AML procedures and the AML legal framework applicable to it.

If you would like to discuss further, please contact your usual A&O Shearman contact.