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Regulatory Update

U.K. Financial Institutions – New Guidelines on Acquisitions and Changes in Control

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The U.K.'s banking and financial services regulators have recently issued guidance updating their approach to handling applications to approve acquisitions of U.K.-regulated businesses.

This guidance is of interest to potential investors and current controllers of U.K.-regulated firms. The new guidance replaces existing EU (pre-Brexit) guidance and is essential reading as it covers the regulators':

- Expectations for submitting a change in control notification;
- The criteria that will be applied in assessing an application for approval; and
- The potential use of regulatory powers to impose conditions on an approval.

Background to Current PRA and FCA Rules

Investing in a U.K.-regulated financial institution will require the prior approval of the Prudential Regulation Authority (**PRA**) and the Financial Conduct Authority (**FCA**) where certain thresholds are met. Typically, this is on the acquisition of a 10% plus stake in the target firm. But the requirement for a regulatory consent can also apply where the investor intends to acquire a smaller interest in the regulated business. This will include where the acquirer:

- Is deemed to be *acting in concert* with another party so that aggregation of shareholdings will apply;
- Has *significant influence* over the target even though the acquirer holds less than 10% of the target's shares; and/or
- Does not invest directly in the regulated target firm but has an indirect investment.

The control test based on a 10% shareholding is binary and straightforward to apply. However, cases where an investor is to be regarded as acting in concert holds significant influence or has an indirect holding can be harder to identify.

Obtaining approval to a change of control is a well-trodden path and U.K. regulators have staffed up to handle applications. While it is usually not a problematic process, investors seeking approval must provide detailed disclosure about themselves. The approval process will inevitably slow down a deal.

U.K. requirements in this area are based on pre-Brexit EU laws (the EU's Acquisitions Directive) and we summarise below the U.K.'s refreshed guidance.

U.K. Guidance

On 1 November 2024, the PRA's and FCA's new package of proposals—including a new PRA supervisory statement and new FCA non-handbook guidance—replaced the European Supervisory Authority's *Joint Committee Guidelines on Acquisitions and Increases of Qualifying Holdings in the financial sector* (better known as the **3L3 Guidelines**).

Of particular interest to our clients will be the illustrative, non-exhaustive guidance the FCA has produced on how it expects firms to interpret **key concepts** in identifying controllers as part of a proposed acquisition (or increase in control) for the purposes of the Financial Services and Markets Act 2000.

"Significant Influence"

We often see clients rely on a percentage holding as marking the threshold for a change in control requirement. We have already mentioned above that the threshold is usually 10% of the shares in the target firm, though this can vary. However, the change in control process is also triggered where a person acquires any shares (i.e., less than 10%) in a target *and* also acquires 'significant influence'.

The FCA guidance expands on examples of what might constitute material matters in making the determination of 'significant influence', and therefore trigger the need for clients to obtain prior consent in the context of a transaction. Crucially, an incoming investor must consider the matters reserved to shareholders when determining whether they will acquire 'significant influence'. The FCA states that significant influence can arise where a shareholder can make recommendations to the board that are generally followed. The ability to appoint or remove members of the board of directors and veto rights over material matters are also indicators of 'significant influence'.

Overall, the updated guidance emphasises that the ability to direct or influence decisions is sufficient to constitute control. While power over board appointments is often a trigger for needing regulatory approval, rights that fall short of this can still bring an investor into the change in control regime.

"Acting in Concert"

Another area crucial to any kind of syndicate transaction is a potential requirement to aggregate holdings where persons may engage in concerted exercise of voting power in a target. While the FCA acknowledges that the term 'acting in concert' has a potentially wide meaning, it has confirmed an indicative approach for circumstances that will not amount to 'acting in concert' in a manner requiring aggregation of their holdings for the purposes of deeming the firms to be a parent of a U.K.-authorised firm.

The FCA also covered its expectations of interpretation for 'deemed voting power', 'passive shareholder agreements', 'conditional agreements', 'pre-emption rights', 'drag along rights', 'tag along rights', and the Takeover Code definition of "acting in concert".

"Indirect Controllers"

Of further interest to our clients will be the FCA's new guidance intended to help notice-givers identify controllers with respect to limited partnership (**Fund**) structures with one or more general partners (**GP**) with unlimited liability and one or more limited partners (**LPs**) with limited liability.

The FCA has said that the particular circumstances of GPs and Fund arrangements with an investment manager should be considered on a case-by-case basis, in particular where Funds share a common GP and the aggregation of voting rights of the Funds amounts to the GP becoming an indirect controller.

It further notes that LPs may be considered a controller depending on their proportional interest. Significantly, the FCA encourages firms to seek legal advice for these types of complex ownership structures to determine.

Early FCA Engagement on Particularly Complex and/or High-Risk Transactions

In an attempt to follow its self-proclaimed "same risk, same regulation" approach, the FCA has decided not to dictate specific guidance for private equity firms or hedge funds, noting that, although their market behaviour is different, the means through which these types of structures exercise control is similar and should therefore receive the same regulatory treatment as other controllers.

That said, the regulator does appear to appreciate the vast variety in the types of Fund and similar structures, and said that it will analyse all proposed controllers on a case-by-case basis, paying particular regard to (and requesting further information from): **sovereign wealth fund, private equity or hedge fund ownership at 20% or more**; **complex groups**; and **transactions where the acquisition is funded with "substantial debt financing"**, (which remains an undefined term).

The FCA has also acknowledged that it may need to waive certain notification requirements where the information is difficult to obtain, such as a circumstance where the proposed controller is a government or government body/department/ministry.

Impact and Takeaways

It is critical to consider early on in **any** transaction where a regulated entity sits within the stack and the requirement for our clients to identify and file a change in control notification with the FCA to avoid delays or involuntarily crossing a controller threshold.

This will help the firm leave enough time to gather enough supporting material relevant to its application. Our early engagement with the FCA will allow them to consider the level of information required as part of the notification.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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