



Funds Finance: Scottish Limited Partnerships and the PSC Regime – Lenders Take Note!

Despite some industry insiders predicting that they'd overshoot the deadline for implementing beneficial ownership disclosure requirements of the *Fourth Money Laundering Directive* (EU 2015/849), the Department for Business, Energy and Industrial Strategy (**DBEIS**) has finally introduced the much-trailed overhaul of the "persons with significant control" (**PSC**) regime that currently applies to UK companies and limited liability partnerships (**LLPs**).

As promised by DBEIS and partly in response to concerns over the alleged use of Scottish limited partnerships (**SLPs**) in fraudulent activity in a number of overseas financial transactions, the regime has been extended to SLPs and Scottish qualifying partnerships – partnerships where each partner is a corporate entity (**SQPs** and, together with SLPs, collectively referred to as **eligible Scottish partnerships**). This note doesn't deal with the new rules for registering SQPs as such at Companies House. SLPs are already so registered.

The amended PSC rules for UK companies and LLPs came into force on 26 June 2017 under *The Information about People with Significant Control (Amendment) Regulations 2017* and this note doesn't deal with the changes made for companies and LLPs.

The rules governing beneficial ownership disclosure for eligible Scottish partnerships mirror the rules for UK companies and LLPs to a large degree and also came into force on 26 June 2017 in the form of *The Scottish Partnerships (Register of People with Significant Control) Regulations 2017* (the **Scottish Rules**), although eligible Scottish partnerships effectively have until 7 August 2017 to begin disclosing and registering beneficial ownership information at Companies House¹.

Implications for Funds Finance transactions involving SLPs

SLP are commonly used in UK fund structures because unlike English limited partnerships, they have separate legal personality which means that, in addition to being able to enter into contracts, grant security and own assets in their own name, SLPs can act as a general or limited partner in other limited partnerships within the fund structure.

1. General Partners and Limited Partners are potential PSCs

Under the new Scottish Rules, the PSC for an SLP is any individual or relevant legal entity who meets one or more of the following conditions in relation to the SLP:

- Directly or indirectly holds rights over more than 25% of the surplus assets on a winding up;

- Directly or indirectly holds more than 25% of the voting rights;
- Directly or indirectly holds the right to appoint or remove the majority of those involved in management;
- Otherwise has the right to exercise, or actually exercises, significant influence or control; or
- Holds the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm which is not itself a legal entity, but would itself satisfy any of the first four conditions if it were an individual.

The Scottish Rules contain detailed guidance on the various tests for meeting the above conditions but given the nature of the General Partner's role in a typical SLP used for UK fund structures, it should be assumed that most General Partners (or the individuals/entities controlling them) will need to be named as a PSC and provide the relevant prescribed information, with Limited Partners potentially qualifying as PSCs depending on the make-up of the fund's investor-base and the terms of the SLP's limited partnership agreement (**LPA**)².

2. Drafting errors and oversights – the Scottish Rules need to be amended

Unlike the PSC rules for UK companies (at least in relation to English registered companies) no exception from the ambit of the PSC regime is made for rights in SLPs that are held in security in connection with lending in the ordinary course of business. Instead, Paragraph 18 of Schedule 1 to the Scottish Rules contains a provision that is intended to exclude "rights attached to shares held by way of security" which appears to be either (a) a drafting error, if the intention is to exclude anyone holding in security rights in an SLP given that shares in partnerships do not technically exist in Scotland or (b) an oversight, if the reference to shares is intended only to exclude anyone holding in security rights attached to shares in a company that constitutes a PSC in relation to the relevant eligible Scottish partnership³.

No doubt the drafting intention will become clearer over time with further guidance from DBEIS, however, other obvious errors spotted thus far include a flaw in the

1. The PSC Register for eligible Scottish partnerships opens on 24 July 2017 but eligible Scottish partnerships have, in most cases, 14 days to provide the relevant PSC information.

2. Fund managers may also be PSCs.

3. Unless "rights attached to shares" can be convincingly construed as "rights", "rights relating to a partnership", "rights originally held as a partner" or words to that effect – otherwise it is difficult to place reliance on such a construction.



enforcement procedure at Paragraph 16(1)(a) of Schedule 2 of the Scottish Rules which states that it is an offence for any PSC to fail to comply with their duty to update PSC information supplied about them but cross refers to a regulation containing no relevant duties rather than to Regulation 13 containing corresponding duties on a PSC to supply relevant information itself without request in the first place. Whether this means that compliance with Regulation 13 can still be enforced by the threat of criminal sanctions is out-with the scope of this note, however, we look forward to reporting on future developments on this issue.

3. Will secured Lenders need to register as PSCs?

Following in the same vein as noted in the paragraphs immediately above, the PSC rules for UK companies and LLPs contain a much-debated drafting loop-hole that arguably requires security holders to be named as a PSC for Scottish companies where fully perfected fixed security has been taken over the company's Scottish shares⁴. Under Scots law, this form of security involves taking a full legal title transfer to the shares and registering the security holder or their nominee in the company's register of members.

The Scots law equivalent of taking share security in an SLP is an assignation in security of a Limited Partner's full rights in the SLP (usually by reference to rights under the SLP LPA). However, taking such security – which similarly involves a full legal title transfer of the Limited Partner's rights – is uncommon or usually not advisable in Fund Finance transactions as it effectively makes the security holder a partner in the SLP and (unless the SLP is registered as a Private Fund Limited Partnership) the transfer has to be advertised publicly in the Gazette (an official UK public record) before the transfer is considered effective⁵.

Instead, it is more common to take fixed security over a Limited Partner's rights to the economic interests in the SLP e.g. the right of the Limited Partner to receive distributions and payments due from the SLP under the terms of the SLP LPA (referred to as **Distributions Assignations**). Such security (which doesn't involve securing the Limited Partner's full rights in the SLP) will not automatically make the security holder a Limited Partner in the SLP or normally require advertisement in the Gazette. Furthermore, this form of security over specific rights will not, in our view, require the security holder to be named as a PSC for the SLP under the Scottish Rules unless the rights assigned (the **Assigned Rights**) expressly include the right to 25% or more of the surplus assets of the SLP on a winding-up (being the first condition for determining a PSC for an SLP under the Scottish Rules).

Whilst it is possible that the drafting of many existing

Distribution Assignations will secure Assigned Rights that (on the face of it) potentially cover surplus assets of the SLP on a winding-up and that this could arguably qualify a secured lender as a PSC, in our view strong arguments can be made against this proposition on the grounds that payments recoverable under such security in repayment of a secured debt would not in themselves normally qualify as surplus assets of the SLP on winding-up. On that basis, we think that most secured lenders with an existing Distributions Assignation should assume that they are not a PSC unless or until presented with convincing evidence to the contrary by the relevant SLP⁶.

Equally, secured lenders who are granted assignations by SLPs of rights to receive undrawn loan commitments and other payments from their Limited Partners (referred to as **Commitments Assignations**) will not qualify as PSCs in terms of the conditions for determining a PSC under the Scottish Rules.

Nonetheless, secured lenders should still be mindful of the potential requirement to be named as a PSC in relation to any SLP where enforcement of Partner security would result in the secured lender stepping into the shoes of that Limited Partner, General Partner or Manager.

4. How will the PSC regime affect secured lending deals involving SLPs?

Under the Scottish Rules, eligible Scottish partnerships have similar disclosure requirements and obligations to take steps to identify registrable individuals and relevant legal entities that qualify as PSCs as those currently applicable to UK companies and LLPs, with similar penalties for non-compliance⁷.

Whilst most of these requirements and obligations will be internal compliance matters for most SLPs and should not have an impact on most secured lenders, Schedule 2 to the Scottish Rules sets-out certain measures that SLPs can take against any person with a "relevant interest" in the SLP who fails to comply with a notice request from the SLP to confirm or supply relevant PSC information. As the definition of a "relevant interest" is very wide, General and Limited Partners' interests in an SLP will in many cases fall into this category.

As with the PSC rules for UK companies and LLPs, SLPs may issue a warning notice to such persons informing them that they will issue a restrictions notice on that person if the original notice requesting PSC information (or confirmation of such information) is not complied with within a month and a valid reason for non-compliance has not been supplied.

If a restrictions notice is subsequently issued by the SLP to a person with relevant interest in the SLP, any lender

4. As noted above, conventional English share security is exempt from the PSC rules.

5. As noted above, in this instance a security assignee probably would be a PSC where a security transferee of shares in a company may not be a PSC.

6. Supported by the argument above that the Scottish rules have failed to create an offence by a PSC failing to supply relevant information in the first place.

7. Subject to the limitations identified with Paragraph 16(1)(a) of Schedule 2 of the Scottish Rules.



providing facilities to that SLP needs to sit up and start paying attention.

5. Restrictions Notices – Lenders Beware

Paragraph 3 of Schedule 2 to the Scottish Rules sets-out the effect of a restrictions notice in respect of a relevant interest:

- a. Any transfer of the interest is void;
- b. No rights are exercisable in respect of the interest;
- c. Except in a liquidation or sequestration of the eligible Scottish partnership, no payment may be made of sums due from the eligible Scottish partnership in respect of the interest, whether in respect of capital or otherwise;
- d. An agreement to transfer an interest that is subject to a restriction is void; and
- e. An agreement to transfer any associated right (otherwise than in a liquidation) is void.

Whilst there are circumstances where the effect of a restrictions notice can be reversed, the process involves an application to the Scottish courts and generally only applies to agreements to transfer rather than transfers of interests.

6. Restrictions on granting fixed security

As noted above, taking fixed security over SLP rights and interests involves a full legal title transfer and therefore Scottish fixed security granted over certain SLP rights and interests may be potentially at risk from restrictions notices as they affect “transfers” and any “agreement to transfer.”

Restrictions notices do not apply to obligations owed by General and Limited Partners to the SLP and therefore should not prevent an SLP from granting fixed security over rights it holds in terms of its LPA, such as a Commitments Assignment.

Restrictions notices will however prevent partners from granting fixed security over their relevant interests in an SLP or agreements to transfer such interests or associated rights. Consequently, depending on how “relevant interest” (in terms of Schedule 2 of the Scottish Rules) is interpreted, Distributions Assignations are potentially at risk and possibly also (although to a lesser extent) Commitments Assignations which include an assignment by the General Partner of its right to issue drawdown notices for undrawn loan commitments⁸.

7. Relevant Interests

Paragraph 2 of Schedule 2 of the Scottish Rules sets out what qualifies as a relevant interest but the drafting in our opinion is not clear and leaves a number of questions unanswered.

Under Paragraph 2(1) of Schedule 2 a person holds a “relevant interest” in an eligible Scottish partnership if the person (a) holds any interest in the eligible Scottish partnership, (b) holds any voting rights in the eligible Scottish partnership, or (c) holds the right to appoint or remove any of the persons entitled to take part in the management of the eligible Scottish partnership. To help clarify matters, Paragraph 2(3) of Schedule 2 states that Parts 2 and 3 of Schedule 1 applies for interpretation of Paragraph 2(1) of Schedule 2⁹. Whilst Parts 2 and 3 of Schedule 1 provide examples of how interests will be deemed to be held directly and indirectly in an eligible Scottish partnership, through a chain of legal entities or otherwise, and what constitutes voting rights, control of a right and significant influence or control, Paragraph 8 of Schedule 1 sets out what an interest in an eligible Scottish partnership looks like:

- a. holding, directly or indirectly, the right to surplus assets of an eligible Scottish partnership on a winding up;
- b. holding, directly or indirectly, voting rights in an eligible Scottish partnership;
- c. holding, directly or indirectly, the right to appoint or remove any of the persons entitled to take part in the management of an eligible Scottish partnership;
- d. having the right to exercise, or actually exercising, significant influence or control over an eligible Scottish partnership; or
- e. where the trustees of a trust or the members of a firm that, under the law by which it is governed, is not a legal person, are holding an interest in an eligible Scottish partnership in a way mentioned in sub-paragraphs a) to d) above and a person holds the right to exercise, or actually exercises, significant influence or control over the activities of that trust or firm.

Leaving aside the observation that limbs (b) and (c) of the definition of “relevant interest” in Paragraph 2(1) of Schedule 2 are redundant if b) and c) of Paragraph 8 of Schedule 1 are also used for interpretation, it is not entirely clear whether the list of interests in Paragraph 8 of Schedule 1 is exhaustive, as it is referred to for “interpretation” purposes and Paragraph 2(1)(a) of Schedule 2 refers to a person holding a relevant interest in an eligible Scottish partnership if the person holds *any* interest in the eligible Scottish partnership.

That the Scottish Rules make a distinction between “interests” and “associated rights” is also of relevance, the latter term being defined as (in relation to a relevant interest) “a right to receive payment of any sums due from the eligible Scottish partnership in respect of the relevant interest.”¹⁰ In our view, the distinction between the two terms means that the transfer of an “interest” or an agreement to transfer an “interest” can be interpreted as referring to

⁸. References in this note to a General Partner granting an assignment over its right to issue drawdown notices etc. apply also to any Manager appointed to the SLP that is considered a PSC for that SLP and has the right to issue such drawdown notices etc.

⁹. Paragraph 2(2) of Schedule 2 of the Scottish Rules also states that references to the “relevant interest” are to the interest or right in question so (perhaps confusingly) a relevant interest can mean a right as well as an interest.

¹⁰. Paragraph 3(6) of Schedule 2 of the Scottish Rules.



a Limited Partner's full interest in an SLP (comprising one or more of the rights listed in Paragraph 8 of Schedule 1) rather than specific or separate rights (not falling into any of the categories of rights listed in Paragraph 8 of Schedule 1), the latter of which would appear to fall into the category of "associated rights," or out-with these definitions altogether.

On that basis, it would appear that fixed security granted by partners over their full interests (comprising one or more of the rights listed in Paragraph 8 of Schedule 1) in an SLP are prohibited once a restrictions notice is in place whereas fixed security granted by partners over specific rights (such as the right to receive distributions and loan repayments from the SLP or the General Partner's right to issue drawdown notices) are not caught, albeit transfers of rights to distributions that qualify as surplus assets on a winding-up of an SLP might be caught as they potentially constitute one of the "interests" listed in Paragraph 8 of Schedule 1, and agreements to grant security over rights to receive payments in respect of relevant interests (i.e. agreements to transfer) are similarly prohibited once a restrictions notice is in place.

8. Assignations of specific rights still potentially restricted

As noted above, it is unusual in a Funds Finance transaction to take fixed security over a partner's full interest in an SLP whereas assignations in security over specific rights are the norm, however, a secured lender may find that their fixed security over specific partner rights such as the right to receive distributions or issue drawdown notices are still affected by a restrictions notice.

Paragraph 3 (1)(b) of Schedule 2 states that when a restrictions notice is in place in respect of a relevant interest "no rights are exercisable in respect of the interest." Unfortunately, it is unclear how widely "no rights" should be interpreted in respect of a relevant interest and whether this includes related rights or only the actual right itself that forms the relevant interest¹¹ – for example, the rights of a General Partner under an SLP LPA to issue drawdown notices or call for undrawn loan commitments from Limited Partners will not qualify as a "relevant interest" in terms of the rights listed in Paragraph 8 of Schedule 1. However, if such drawdown notice rights are considered rights exercisable in respect of another relevant interest, such as the General Partner's right to exercise significant influence or control over the SLP, the security position becomes less certain and such rights are potentially caught by Paragraph 3 (1)(b) of Schedule 2.

Whilst strong arguments can be put forward that the above scenario would not prevent a General Partner from carrying out its duties and obligations (in terms of the LPA) such as issuing drawdown notices, on enforcement of a Commitments Assignment it could restrict the security holder from exercising that secured right whilst the

restrictions notice was in place. In mitigation, we think that it is unlikely that many General Partners will be subject to restrictions notices if they are responsible for complying with the PSC regime on behalf of the SLP but care will need to be taken where such responsibility has been devolved to other parties such as a Manager.

Similarly, under Paragraph 3 (1)(c) of Schedule 2 where a restrictions notice is in place, no payments may be made of sums due by the SLP (capital or otherwise) in respect of a relevant interest unless the SLP is being wound-up. Again, it is unclear how widely "no payments" should be interpreted in respect of a relevant interest and whether this includes related payments (for example, pre-winding-up distribution payments due to a Limited Partner in general under the terms of the LPA) or only payments in respect of the actual right that forms the relevant interest (for example, payments due in respect of the right to receive surplus assets on a winding-up).

From a security holder's perspective, if the wider interpretation is followed then it would make it difficult for a secured lender to enforce a Distributions Assignment granted once a restrictions notice is in place. Some comfort should be taken that payments under Paragraph 3 (1)(c) of Schedule 2 are not restricted if the SLP is in sequestration (i.e. liquidation), although whether or not a secured lender would have the option of forcing an insolvency process on the SLP in an enforcement scenario would depend on whether the SLP was an obligor under the relevant finance documents in any secured lending transaction.

9. What protection measures should Lenders be thinking about?

Unlike UK companies and LLPs, eligible Scottish partnerships do not need to maintain their own PSC register and therefore the only source of PSC information will be the PSC information filed by the SLP with the registrar of limited partnerships at Companies House.

When dealing with SLPs, lenders will need to satisfy themselves as part of their KYC or due diligence process that the relevant SLP has duly complied with its PSC obligations by reviewing the limited partnership file at Companies House and related PSC information that is available.

Lenders should also ensure that there is ongoing compliance with the PSC regime by including SLP and/or General Partner undertakings in any loan agreements or Scottish security documents to that effect. They should also include in the relevant finance or security documents warranties that all relevant partners (including any persons with a controlling interest in such partners) have complied with any requests by the SLP for PSC information (in terms of section 10 and 11 of the Scottish Rules) and that no warning or restrictions notices have been issued in respect

¹¹ See Footnote 9 above re rights being relevant interests.



of any persons with a relevant interest in the SLP.

Where fixed security is being granted in respect of SLP rights and interests, lenders may also want to link Events of Default under the relevant finance documents to the issuance of any warning notices, and allowing the security to be enforced prior to the issue of a restrictions notice, after which it may become difficult to enforce if the lender wishes to sell or dispose of the relevant Assigned Rights rather than collecting the sums due under the relevant Assigned Rights.

Comment

1. The extension of the PSC regime to SLPs and SQPs should (in theory) assist lenders and other third parties dealing with SLPs, offering greater transparency on ownership structures and help combat fraud and money laundering activities (for a recent report on the abuse of SLPs for offshore corruption and money laundering activity, see <http://www.transparency.org.uk/publications/offshore-in-the-uk/>).
2. Compliance with the PSC regime will increase administrative responsibilities for managing and operating SLPs and enhance ownership/investor participation transparency although it remains to be seen whether this will make SLPs less attractive to investment fund managers and investors as UK limited partnerships are in any event required to file certain details of their General and Limited Partners at Companies House.
3. The regulations do not appear to have been drafted with an in-depth understanding or appreciation of the forms of security commonly taken over SLP rights and interests or their operation in secured lending transactions, perhaps due to the speed in which the regulations were brought in to force, and we would recommend revisiting a number of provisions should the opportunity arise.
4. From 24 July 2017¹², ensuring that SLPs and persons with relevant interests in SLPs are in compliance with their PSC obligations will be a live issue for Funds Finance

Lenders and other secured lending transactions involving SLPs and protection measures should be considered to safeguard Scottish fixed security and the ongoing operation of specific SLP rights and interests.

5. Subject to taking the relevant protection measures, fixed security granted over SLP rights or interests in secured lending transactions should on the whole be largely unaffected by the PSC regime. In summary:
 - a. Commitments Assignations should not be affected by the Scottish Rules unless the General Partner (or other entity responsible for issuing drawdown notices under the terms of the LPA) is subject to a restrictions notice when the security is granted (which on balance does not seem likely to occur very often); and
 - b. Distributions Assignations will similarly be unaffected by the Scottish Rules unless the SLP attempts to use the security as grounds to register the security holder as a PSC (noting that there are strong arguments against such grounds for registration) or unless a restrictions notice is in place when the security is granted, in which case it may be necessary to sequester the SLP (if party to the transaction as an Obligor) on enforcement in order to lift the restriction on certain payments secured by the Distributions Assignment.
6. Protections are available to third parties under the Scottish Rules¹³ where a restrictions notice unfairly affects third party rights in respect of a relevant interest, however, the regulations place the onus on the affected third party to apply to the Scottish courts for redress. There is also no guidance on what constitutes “unfairly affects” although we would suggest that it should include scenarios where a secured lender has taken an assignment in security over an SLP right or interest on the strength of an undertaking from the SLP that no warning or restrictions notice have been issued by the SLP when the assignment in security is granted which is then compromised by a restrictions notice.

¹² The PSC Register for eligible Scottish partnerships opens on 24 July 2017.

¹³ Paragraph 4 of Schedule 2 of the Scottish Rules.

This briefing note is for general information only and should not be relied upon as advice on your specific circumstances. If you wish to discuss any issues highlighted in this this briefing note, please contact Rod MacLeod, Hamish Patrick or Andrew Kinnes.



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