

## The PSC Register and Scottish Shares Pledges



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Since 6 April 2016, UK incorporated companies and LLPs have been required to maintain a 'Person of Significant Control' Register (**PSC Register**). The PSC Register is a statutory register of individuals with significant control over a company or LLP.

We have covered the PSC Register in detail [here](#) and our Pensions team have looked at the implications for corporate trustees on UK pension boards [here](#). The introduction of the requirement to maintain a PSC Register also impacts on banking transactions where a lender is taking security over shares in a Scottish incorporated company.

### Recap on the PSC Register regime

The PSC Register regime applies to individuals with "significant control" (**PSCs**) and "relevant registerable legal entities" (**RRLEs**). To be an RRLE, a legal entity must (i) be required to hold its own PSC Register *or* (ii) be exempt from holding its own PSC Register by virtue of being subject to transparency requirements *and* must be the first legal entity in the company's chain of indirect holders of its shares or control rights.

If they meet one or more of the PSC conditions, individuals and RRLEs will need to be included in a company's PSC Register. The PSC conditions are that an individual or RRLE:

1. Hold (directly or indirectly) 25% or more of the shares in the company; or
2. Hold (directly or indirectly) 25% or more of the voting rights in the company; or
3. Have the right (directly or indirectly) to appoint or remove directors with a majority of the voting rights of the board; or
4. Have the rights to exercise, or actually exercise, significant influence or control over the company; or

5. Have the right to exercise, or actually exercise, significant influence or control over the activities of a trust or firm, the trustees or partners of which satisfy one of the other conditions.

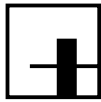
### Scottish Share Security

Lenders will often take fixed security over shares in a Scottish company as part of their security package. In order to create a valid fixed security interest under Scots law, it is necessary for the legal title to the shares in that Scottish company to be transferred to the lender, with the terms of the security being set out in a shares pledge document. This involves the directors of the Scottish company updating the register of members of that company to reflect the change in shareholding. The lender will therefore appear on the register of members as the holder of the shares.

The Scottish position can be contrasted with the position in England where a lender would normally take an equitable charge over the shares in the relevant English company. The advantage of this approach is that title to the shares does not have to be transferred to the lender.

### Consequences for Secured Lending Transactions

What impact does the PSC Register regime have on lending transactions involving Scottish share security?



## 1. Warning Notices and Restrictions Notices

The main implication is the potential for a “warning notice” or a “restrictions notice” to be issued in respect of the shares over which a lender has security. The PSC Register regime requires a company to take steps to identify PSCs and RRLEs, including a requirement to give notice to anyone it knows or has reasonable cause to believe to be a PSC or RRLE. If a potential PSC or RRLE does not respond to a notice from a company containing a request for information then a “warning notice” may be issued. If there is no response to a “warning notice” within a month then a “restrictions notice” may (at the discretion of the company) be issued.

If a “restrictions notice” is issued then the shares cannot be transferred without a court order. This means that a holder of security over shares would not be able to enforce their security without first taking steps to have the restriction lifted. This will clearly be a concern for any lender. As such, part of the due diligence process when a lender is considering taking security over shares in a Scottish company will involve checking the relevant company’s PSC Register to ensure that the shareholder has been complying with their obligations under the PSC Register regime and that no “warning notice” or “restrictions notice” has been issued in respect of the shares.

As well as checking compliance with the PSC Register regime at the point that the share security is granted, a lender will want to ensure that there is ongoing compliance with the legislation. The simplest way to ensure this would be to include an undertaking to this effect in the shares pledge (or the loan agreement). Lenders may also want to include a provision that the issuing of a warning notice would trigger an event of default, allowing enforcement of the security over the shares before a restrictions notice is issued.

## 2. Lender appearing on the PSC Register

The other consideration for lenders when taking security over shares in Scottish companies is the impact of the PSC Register regime on the lender itself. The legislation establishing the PSC Register anticipates that lenders will take security over shares and contains a specific carve-out. Paragraph 23 of the new Schedule 1A of the Companies Act 2006 (**CA06**) (inserted by The Small Business, Enterprise and Employment Act 2015) provides that:

*Rights attached to shares held by way of security provided by a person are to be treated for the purposes of this Schedule as held by that person:*

- a. where apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in*

*accordance with that person’s instructions, and*

- b. where the shares are held in connection with the granting of loans as part of normal business activities and apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in that person’s interests.*

On the face of it, the legislation appears to provide a carve out from the PSC Register regime in respect of lenders who take security over shares. However, on a closer reading of the carve out, it doesn’t appear to exclude lenders who actually take legal title to the shares in a Scottish company. This is because the carve out applies to *rights* attaching to shares held by way of security, rather than to the holding of the shares in security itself.

A lender holding shares under a Scots law shares pledge will therefore clearly meet the requirement of Condition 1 of the PSC Register regime (i.e. they “*Hold (directly or indirectly) 25% or more of the shares in the company*”) and, provided they also meet the conditions for being an RRLE outlined above will then require to be entered on the company’s PSC Register.

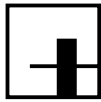
It is interesting to note that Paragraph 23 of the new PSC Schedule in the CA06 referred to above, exactly tracks the wording that appears in paragraph 7 of Schedule 6 of the CA06. The wording in paragraph 7 interacts with the definition of “subsidiary” in section 1159 of the CA06 and is used to clarify that a company will not cease to be a “subsidiary” of another entity (its parent) by virtue of the fact that its shares are subject to a security interest. Section 1159 of the CA06 defines a “subsidiary” in the following way:

*A company is a “subsidiary” of another company, its “holding company,” if that other company:*

- a. holds a majority of the voting rights in it, or*
- b. is a member of it and has the right to appoint or remove a majority of its board of directors, or*
- c. is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it,*

*or if it is a subsidiary of a company that is itself a subsidiary of that other company.*

When the carve out in paragraph 7 is read alongside the definition of “subsidiary”, the carve out operates so that a lender would not be treated as holding the “rights” attached to the shares subject to the security interest. It is helpful to contrast the drafting of the PSC conditions



with the drafting of the “subsidiary” definition above. There is a correlation between Condition 2 and s1159(a), Condition 3 and s1159(b) and Condition 4 and s1159(c) and so the carve out from the PSC Register regime set out in Paragraph 23 does appear to apply to a lender holding security over shares in a Scottish company. However, there is no equivalent to Condition 1 of the PSC Register regime in section 1159 of the CA06, which highlights the fact that the carve out in Paragraph 23 is inadequate.

While it appears that all fixed security over shares was intended to be subject to the exception set out in Paragraph 23, our view is that in the case of a pledge of the shares in a Scottish company, the unfortunate drafting of the legislation (i.e. the fact that the carve out doesn’t apply to Condition 1) suggests that the security holder should be entered on the relevant company’s PSC Register. Given the clear intention of Paragraph 23 and the guidance that has been published by Government, there has been some discussion in the profession as to whether this interpretation is correct. There is no obvious reason why Scottish companies should be treated differently from English companies for the purpose of the PSC Register regime, as the regime is meant to apply on the same basis across the UK. Indeed, the only real reason for the difference is because security rights are constituted differently under Scots law. It appears that the most likely explanation for the difference is that this distinction was overlooked when the legislation was drafted.

### 3. Obligations to Notify

Why is all of this relevant to a security holder? Section 790G of the CA06 imposes a statutory duty on any individual or RRLE that is required to be entered onto a PSC Register (whether they know that is the case or reasonably ought to know that is the case) to comply with certain statutory obligations.

*Under s790G, the individual or RRLE must:*

- a. notify the company of the person’s status (as a registrable person or registrable relevant legal entity) in relation to the company,*
- b. state the date, to the best of the person’s knowledge, on which the person acquired that status, and*
- c. give the company the required particulars.*

The “required particulars” are set out in s790K and include details such as the name, address, nationality of the person (or governing law of the legal person), the nature of his or her (or its) control over that company and the date on which they became a registrable person in

relation to the company in question. There are also ongoing obligations on individuals and RRLEs under s790H to notify the company of a change in circumstances or if the information they have provided changes. If an individual or RRLE fails to comply with the obligations in s790G or s790H then they will be guilty of a criminal offence. It is also an offence to fail to comply with a notice requesting information issued by a company to an individual or RRLE under s790D or s790E of the CA06.

### 4. Security Trustees and Nominees

The analysis above primarily focusses on Conditions 1 to 4 of the PSC Register regime. However, it is worth briefly mentioning Condition 5, which applies in the case of a trust arrangement and involves a two-stage test. Many secured lending transactions involve a security trustee holding security in trust for a club or syndicate of lenders. If a security trustee holds shares in a Scottish company under a Scots law shares pledge (and therefore satisfies Condition 1) then it is necessary to consider whether anyone has the right to exercise, or actually exercises, significant influence or control over the activities of the security trustee, such as an instructing group of lenders. It will be necessary to consider the particular terms of the security trust arrangements in these circumstances.

Finally, it is worth mentioning that the PSC legislation specifically covers the scenario of a person holding shares as nominee for another person in Paragraph 19 of Schedule 1A of the CA06. When taking a Scots law shares pledge, lenders will often use “nominee” companies to hold the shares for them. Paragraph 19 confirms that the nominee will not be treated as holding the shares and, instead, the person for whom the nominee is acting will be treated as holding the shares. While this clarifies that a nominee would not need to be entered on a company’s PSC Register, it doesn’t affect the position of a lender who has the benefit of security over shares in a Scottish company.

### Comment

1. The drafting of the PSC legislation doesn’t appear to have fully considered its interaction with shares pledges under Scots law.
2. Lenders need to be mindful of the implications of the PSC legislation on their ability to sell the shares in a company on enforcement of a shares pledge. Shares pledges should be drafted with appropriate contractual provisions.
3. If the shares of a Scottish company have been pledged in security, that company will need to consider whether the security holder is an RRLE and will need to comply with their PSC obligations accordingly.



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4. Lenders need to be aware, both in respect of existing shares pledges and new shares pledges, that they may be entered on a company's PSC Register if they hold shares of that company in security (provided they are an RRLE). In any case, we would recommend that a lender holding shares in security should notify the Scottish company of their status as an RRLE under s790G of the CA06.
5. If a lender is entered on a PSC Register, it will be subject to ongoing obligations to provide information. Failure to comply with these obligations is a criminal offence.
6. The implications of the PSC Register regime may be far-reaching in the context of syndicated lending or secured bond financing transactions. It will be necessary to consider the terms of the finance documents to establish whether other entities may require to be entered on a company's PSC Register.

*This Bulletin 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 bulletin, please contact Andrew Kinnes or Craig Nicolson.*

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