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John Cunningham (MG02)
Prudential Regulation Authority
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London
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By email: cp25/23@bankofengland.co.uk

23 February 2024

Dear John Cunningham,

Re: CP23/23: Prudential assessment of acquisitions and increases in control

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of over 600 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. In 2022, £27.5bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized enterprises (SMEs).

Thank you for the opportunity to comment on a draft PRA Supervisory Statement (SS) and draft FCA guidance on the prudential assessment of acquisitions and increases in control. As most of our members are FCA authorised firms, our comments are directed at the FCA's guidance consultation. For convenience, we have commented on sections in the order that they appear in the draft guidance.

Decision to acquire

The draft guidance states that the FCA expects to take into account whether the proposed controller (1) was or should have been aware of the acquisition/increase of control and the transaction giving rise to it and (2) had the ability to influence, object to or prevent the proposed acquisition or increase of control.

An investor in a private equity or venture capital fund will often not (actually or constructively) be aware in advance of investments being made by the fund, nor will it typically have the ability to influence, object to or prevent the proposed acquisition or increase of control. We would therefore welcome a clarification that whilst a private capital fund *manager* will of course take a decision on behalf of the fund to acquire or increase control (and so require approval), *investors* in private equity or venture capital funds will not generally be regarded as having taken a decision to acquire or increase control. For essentially the same reason, i.e. that investors will generally play a passive role in contrast to the active role played by the manager, we would also welcome a statement that once investors are made aware of the transaction, there is no need for them then to notify the FCA in accordance with the "If you acquired control but weren't aware" section of the FCA's webpage on change of control.

Significant influence

Broadly, we welcome examples in guidance that are designed to be more relevant to the UK authorised persons and based on practical, real-world PRA and FCA specific examples. These can help firms to understand the regulators' expectations.

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As part of this guidance consultation, we would welcome acknowledgement from the regulators that factor i), membership of the UK authorised person, or its parent's board, i.e. a single director, would not, on its own, amount to significant influence. Considerations such as the size of the board and the role of the director (whether executive or non-executive) should also be taken into account. There is a precedent for this in the Government's statutory guidance on the meaning of "significant influence or control" over companies in the context of the register of people with significant control. This guidance is clear that where the person is a director of a company, this is a role which would not, on its own, result in that person exercising significant influence or control. We would welcome a similar clarification in finalised guidance on the factors relevant to any determination of whether significant influence over the management of the UK authorised person may be exercised.

We suggest that factor vii), on the existence of veto rights over "material matters" in relation to the running of the business, requires further explanation to help ensure consistency in interpretation and to avoid confusion.

We also note that the draft guidance on the meaning of 'significant influence' differs from existing FCA Handbook guidance on significant influence in MiFIDPRU 2.4.11G. For simplification and consistency, the FCA's guidance on factors relevant to any determination should be aligned.

Submitting the notification (inc pre-notification engagement)

We acknowledge that the regulators might require additional information in certain circumstances and agree that pre-notification can help to avoid unnecessary delays in the notification and assessment process of significant and complex transactions.

We note the FCA's proposal for its draft guidance to "largely replicate" the 3L3 guidelines. Nonetheless, we also note that the draft FCA guidance goes beyond the 3L3 guidelines, by expanding the scenarios where pre-notification engagement is "encouraged". In particular, the draft guidance encourages pre-notification engagement in the following circumstances, which are not specified in the 3L3 guidelines:

- private equity or hedge fund ownership at 20% or more;
- two or more [FCA] authorised firms; or
- firms that fall under the Investment Firms Prudential Regime.

We suggest it would be preferable to align the draft guidance with the 3L3 guidelines, by removing references to the above scenarios in the final guidance. This would help minimise any potential disparity between the UK and EU approaches, and in turn ensure that the FCA's guidance remains aligned with its secondary objective of facilitating international competitiveness. Nevertheless, should the FCA resolve to retain these sections in its final guidance, we have set out below further comments for the FCA's consideration, including with respect to the scenario applicable to private equity or hedge fund ownership at 20% or more. We note that the draft guidance says the regulators "encourage" pre-notification engagement to determine what additional information might be required in certain cases and would welcome confirmation from the FCA that this is not an expectation or requirement. We think it should be for the proposed controller to decide whether to engage early through pre-notification and where a proposed controller is unable to or chooses not to engage early, we seek assurances from the FCA that this will not prejudice or unduly delay assessment of the notification for an acquisition or increase in control. This is important because there are numerous circumstances in which a proposed controller might be unable or reluctant to engage early, for example, where there are market sensitivities related to the transaction or question marks over deal certainty. Annex 2 of the draft guidance states that "*In the context of a share purchase agreement that provides for the FCA's approval of the purchaser to be obtained before the acquisition is completed, the purchaser will not usually be required to give a section*

178(1) notice prior to entering into the agreement". This may be intended to provide support for the position we advocate here, but we would nevertheless welcome explicit confirmation.

More generally, we are concerned about the preparedness of the FCA to process and respond to a volume of pre-notification engagements alongside its assessment of notifications of acquisitions or increases in control that are on the statutory clock. Until recently, there were significant delays in the regulators' approval of applications, and this was having a substantial negative impact on our members businesses. While we commend the regulators for the improvements that have been made to address delays, we would welcome a commitment from regulators that they will respond to proposed controllers making pre-notification engagements within a set period, in a timely, efficient manner and without undue delay to help firms determine what additional information will be required for notification.

It is also unclear how would-be controllers are supposed to respond to the many references in the draft guidance to the possibility of the FCA requesting additional information ("*In some cases the FCA may request ...*"). Is the intention that the FCA's template change of control forms be amended to reflect these references or is it rather that the FCA *may* choose to engage on these points when reviewing the application? We would welcome further clarity here but note that the template forms are already substantial in length (having grown substantially over time), with some questions seemingly more pertinent to a meaningful prudential assessment of a would-be controller than others. We would not therefore suggest extending the forms further, and if the intention were to include additional information in them, we would suggest rationalising the form first.

To help mitigate against a potential deluge of pre-notification engagements, we would welcome further clarification in guidance on the types of transaction that the regulators think are lower risk and less likely to require additional information from proposed controllers. For example, we recommend that the regulators consider a more streamlined approval process for small AIFMs or commercial investments in businesses whose authorisations relate to non-core business activities, such as ancillary consumer credit or product insurance intermediation, e.g. dentists and online car rental companies, or those involved in brokerage activities. This would free up case workers' time to concentrate on higher risk, more complex transactions involving restructurings or acquisitions of businesses whose primary activity is the provision of financial services. We also note that this approach would be aligned with the 3L3 guidelines, which recommend reduced information requirements in respect of the acquisition by authorised persons of less complex firms.

We are extremely supportive of the approach reflected in the statement in section 4 of the draft guidance that "*the FCA may vary the intensity of the assessment and composition of the required information ... taking into account the UK regulatory history of the controller and whether or not the proposed controller (or its group) is supervised in a third country deemed equivalent*". We consider this a welcome and sensible application of the proportionality principle in the 3L3 guidelines (albeit, as we set out below, the principle itself has not been reflected explicitly). Indeed, we would encourage the FCA to go further and reflect expressly the position it has adopted on an ad hoc basis in the past of granting time-limited approvals (typically of 12 months' duration) to persons or undertakings on the basis that they have previously been approved by the FCA as a controller, subject to them filing a 'no material change' notification on further acquisitions. We suggest this because (1) it is not clearly in the interest of any parties or the FCA for the FCA to be reviewing the prudential soundness of would-be controllers who have already been approved and where there have been no material changes. This would be helpful because the process of obtaining change of control approvals is time-consuming and expensive both for would-be controllers and for the FCA and it is not obvious what benefits this duplication brings; and (2) it would be in line with the FCA's secondary objective of furthering international competitiveness and growth.

Examples of where additional information might be required

Private equity or hedge fund ownership at 20% or more: from a private equity perspective, the 20% ownership threshold is very low and will likely capture every transaction involving a private equity firm as a proposed controller. This helps to align the private equity investors' interests with the managers of the portfolio company – helping to ensure the company achieves its growth potential over time. This differs from hedge funds, which do not usually purchase a controlling interest in a company and use complex trading strategies to try to capitalise on short-term market movements. Given these differences in approach, we recommend private equity and hedge fund ownership is split out, with a better calibrated ownership threshold for private equity,

We would also like to question the relevance of some of the additional information that is likely to be requested from private equity firms:

1) Private equity firms with a UK presence are authorised and regulated by the FCA, and we would have thought that firms deemed suitable for authorisation and subject to ongoing regulation would be suitable proposed controllers.
2) We accept that the regulators may want additional information about the proposed controller's intentions for the target company, but it is not clear how the investment policy or a detailed description of the performance of previous acquisitions are relevant to the FCA's assessment of the application.
3) We also believe that, as authorised and regulated firms, detailed descriptions of the proposed controllers' AML procedures and of the legal framework is unnecessary and duplicative.
4) "Substantial debt financing" is not defined. As the FCA will be well aware, most private equity and venture capital transactions involve some form of debt financing. We would welcome confirmation that the mere fact that a would-be controller forms part of a private equity or venture capital group does not automatically mean that it is substantially leveraged.

Completeness of the notification

There is a long-standing issue around a lack of clarity regarding the basis on which the regulator decides whether an application is complete for the purposes of starting the statutory clock. The result is significant uncertainty for customers of the target business and damage to the competitiveness of PRA/FCA-regulated businesses seeking investment relative to international peers as well as unnecessary cost implications.

We suggest that the regulators' confirmation of receipt of an application should also be deemed as confirmation that the application is complete, thereby starting the statutory clock (with the potential for the regulator to stop the clock should it subsequently discover that the application is not complete). This would allow investments to progress with greater confidence and help to make the UK a more efficient and competitive jurisdiction in which to invest, thereby advancing the regulators' secondary objectives for competitiveness and growth.

General comments

Proportionality principle

We note that the draft guidance does not include chapter 8 of the 3L3 guidelines on the 'Proportionality principle'. We recommend that the new PRA Supervisory Statement and FCA guidance should include similar language on the need for supervisors to carry out the prudential assessment of proposed acquirers in accordance with the principle of proportionality. We would expect to see the proportionality principle retained, particularly as it is a key component of the EU's comparative regime. Again, this is important to help make the UK a more efficient and competitive jurisdiction in which to invest, thereby advancing the regulators' secondary objectives for competitiveness and growth.

Managed on a unified basis

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We understand that the FCA is applying a proportionate approach to assessing the concept of "managed on a unified basis" under section 422(5)(a)(v) of FSMA in the context private equity limited partnerships investing in parallel. For instance, where there are four such limited partnerships which own respectively 55%, 15%, 15% and 15% of the voting rights of a minority controller, only the 55% holder would be treated as a parent undertaking of the controller. It would be helpful if this approach could be reflected in the guidance. We would be happy to discuss this with you in more detail.

Annex 1 – practical examples of the determination of controllers

As this guidance is clearly intended to apply to proposed controllers who are private equity firms, we think it would be helpful to include a practical example in Annex 1 involving private equity.

We also have two specific comments on the diagrams:

Diagram E: The draft guidance states, on p8, that "*It should be noted that the voting power of persons acting in concert will not be aggregated for the purposes of deeming them to be a parent of an undertaking and/or the undertaking to be a controlled undertaking for the purposes of s422(5)(a)(v) of FSMA.*" This is helpful, and consistent with messaging from case officers on recent applications. Diagram E appears to be intended to illustrate this point, but does not capture the more common scenario where there is a 100% parent (X) of a concert party (Y) that is below the notification threshold on an individual basis (e.g. Y holds less than 10%) and only a controller because it is acting in concert with other shareholders with an aggregated holding in excess of the threshold (e.g. Y has 5% of a parent undertaking of the target firm, but is acting in concert with another shareholder (Z) that has 60%). Our understanding is that X would not be a controller in this situation because you apply s422(5)(a)(v) to Y's actual holding, not its deemed holding by acting in concert. It would be helpful if this could be confirmed and illustrated by a diagram.

Diagram B: the third box across the top line (the second "not a controller" entity) is identified as having 100% non-voting shares in the entity beneath. We believe this should be voting shares (as no other shareholder of the entity beneath is indicated, and a company cannot have exclusively non-voting shares), but that this would not change the position that it is not a controller as it is a 100% shareholder of an entity that itself holds non-voting shares. The illustration would be more helpful if this clarification were made, as it is a relatively common scenario.

Working with other UK-based regulators

We would welcome greater collaboration between the FCA and other UK-based regulators to help improve efficiency and reduce duplication across similar change in control processes. For example, please see the Lloyd's of London change of control procedure for underwriting agents which acknowledges the FCA/PRA process. The FCA could consider working with other UK-based regulators, including the Payment Systems Regulator, the Law Society, the Council of Licenced Conveyancers, etc.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours sincerely,

Tim Lewis

Chair, BVCA Regulatory Committee