

Reducing reporting requirements:

A consultation on reform of the
'controllers regime' in Part XII of the
Financial Services and Markets Act 2000

March 2006



HM TREASURY



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HM Treasury contacts

This report can be found on the Treasury website at:

hm-treasury.gov.uk

For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

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CONTENTS

		Page
Chapter 1	Introduction	3
Chapter 2	Responding to the consultation	5
Chapter 3	Current FSMA controllers regime	7
Chapter 4	Issues with the current regime	9
Chapter 5	Proposed solutions	11
Chapter 6	Partial Regulatory Impact Assessment	17
Annex A	EC law provisions	25
Annex B	Proposed legislation	27
Annex C	Consolidated new provisions	33

INTRODUCTION

1.1 This consultation sets out the Government's proposals to amend Part XII of the Financial Services and Markets Act 2000 (FSMA), in order to cut back disproportionate requirements to report information to the Financial Services Authority (FSA). These proposals form part of a ten point action plan of reforms to wholesale and retail financial markets set out in the 2005 Pre-Budget Report, which reflects a number of concerns raised by industry and consumers about financial services regulation.

1.2 In particular, this consultation document seeks views on proposed changes to sections 178 to 192 and section 422 of FSMA, which relate to when persons (whether or not authorised by the FSA) are required to notify the FSA about controlling relationships which they hold, or propose to hold, over a person authorised by the FSA. These requirements are known as the 'FSMA controllers regime'.

1.3 This document provides an overview of the scope and nature of current notification requirements, explains issues which have arisen in relation to the current regime, and proposes solutions. These solutions would be implemented via the introduction of secondary legislation, and would involve reducing the extent of existing notification requirements in order to make them more proportionate.

1.4 Draft implementing legislation is attached together with a Partial Regulatory Impact Assessment.

1.5 Many of the requirements of the FSMA controllers regime stem from EC legislation, and are referred to as 'the underlying EC Directives' in this consultation document. These requirements are article 9 of the EC Investment Services Directive (93/22/EEC), to be replaced by article 10 of the EC Markets in Financial Instruments Directive (2004/39/EC), article 14 of the EC Third Life Directive (2002/83/EC), article 15 of the EC Third Non-Life Directive (92/49/EEC), article 5e of the Undertakings for Collective Investment in Transferable Securities Directive (85/611/EEC as amended by 2001/107/EC) and article 7 of the EC Banking Consolidation Directive (2000/12/EC). Annex A provides more details.

1.6 The European Commission is currently in the process of reviewing article 16 of the EC Banking Consolidation Directive (2000/12/EC), which relates to the supervisory approval process for proposed acquirers of credit institutions, and equivalent provisions in other EC Directives. The outcome of this review is likely to have implications for the FSMA controllers regime. In order to revise article 16 of the EC Banking Consolidation Directive and the other EC Directives an amending EC Directive will first need to be adopted via the co-decision process. Given the time involved in this process we have decided to proceed with the current deregulatory proposals at this point in time, whilst acknowledging that further revisions to the FSMA controllers regime might need to be considered in due course.

2

RESPONDING TO THE CONSULTATION

How to respond

2.1 The consultation period will begin on 22 March 2006 and will run for 12 weeks until 14 June 2006. Please ensure that your response reaches us by that date. We cannot guarantee to consider your response if it arrives after that date.

2.2 Please send responses to this consultation document to the address below. Inquiries or comments about the consultation process should be sent to the same address:

Eve Engledow
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Tel: (+44) (0) 207 270 4381
Email: eve.engledow@hm-treasury.x.gsi.gov.uk

2.3 Please explain in your reply if you represent an organisation, and if so, its membership and coverage. **In accordance with the code of practice on open government, comments will be made publicly available unless respondents specifically request otherwise. If you wish part, but not all, of your response to remain confidential please supply two versions – one for publication on the website with the confidential information deleted and another confidential version for the Treasury team managing this consultation exercise.** Any e-mail response sent from a corporate system may carry an automatically generated message stating that the content of the message should be treated as confidential. If you are replying by e-mail, please make it clear in the body of your response whether or not you wish your comments to be treated as confidential.

Partial regulatory impact assessment

2.4 As highlighted above, the Partial Regulatory Impact Assessment (Partial RIA) is published with this document and should be read in conjunction with it. The Partial RIA lays out implementation options for the two areas highlighted above and considers qualitative, and where possible, quantitative costs and benefits for each option.

2.5 A copy of the Partial RIA can be found on HM Treasury's website: www.hm-treasury.gov.uk or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found on www.hm-treasury.gov.uk/contact/contact_index.cfm

The consultation criteria

2.6 The consultation is being conducted in line with the Code of Practice on Consultation. The six criteria are listed below. A full version can be found at <http://www.cabinet-office.gov.uk/regulation/Consultation/Code.htm>

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.

2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you feel that this consultation does not fulfil these criteria please contact:

Julie Humphreys
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Tel: (+44) (0) 207 270 5543
Email: Julie.humphreys@hm-treasury.x.gsi.gov.uk

2.7 Additional copies of this consultation document are available electronically at www.hm-treasury.gov.uk/consultations_and_legislation/consult_liveindex.cfm

3

CURRENT FSMA CONTROLLERS REGIME

Outline nature of current regime

3.1 Section 178 of FSMA requires all persons to notify the FSA if a step they are proposing to take would result in them acquiring control, or an additional kind of control, or increasing a relevant kind of control over a UK authorised person. Section 190 of FSMA requires persons to notify the FSA if a step they are proposing to take would result in them ceasing to have control of a relevant kind, or reducing a relevant kind of control over a UK authorised person. A person must also notify the FSA within 14 days of becoming aware that they have acquired control or an additional kind of control, or have increased or reduced or ceased to have control without having taken any such step.

3.2 Notifications of an acquisition or increase in control must be submitted to the FSA in writing and must include such information and documentation as reasonably required by the FSA. Within three months of receiving such notifications the FSA must decide whether to approve the change in control, whether to attach conditions to the change of control, or whether to object to the change of control. The approval requirements are that the person who acquires control is fit and proper to do so and that the interests of consumers would not be threatened by their acquisition of or increase in control. When deciding whether these requirements are met the FSA must have regard to its duty to ensure that the regulatory threshold conditions continue to be met.

3.3 If shares are acquired or continue to be held by a person in contravention of any conditions applied by the FSA or in contravention of an FSA notice of objection then, under section 189(2) of FSMA, the FSA may place four different types of restriction on those shares. Under section 189(3) of FSMA, the FSA may also apply to the court for those shares to be sold.

3.4 The exercise of these powers by the FSA is subject to a number of safeguards similar to those which exist in other parts of FSMA. In particular, the FSA is required to issue warning notices and decision notices, and a person receiving a decision notice may refer the decision to the Financial Services and Markets Tribunal. The FSA is also required to consult with competent authorities outside the UK in accordance with regulations made under FSMA¹, and to identify what steps a person must take or refrain from taking in order to satisfy the FSA's approval requirements. Persons subject to conditions applied by the FSA may also apply for those conditions to be varied or cancelled.

¹ FSMA 2000 (Consultation with Competent Authorities) Regulations 2001 (SI 2001/2509), and Financial Conglomerates and Other Financial Groups Regulations 2004 (SI 2004/1862).

Specific scope of current regime

3.5 Section 179 of FSMA specifies when a person is considered to have acquired control over a UK authorised person;

- section 179 (2) sets out eight cases in which control is considered to have been acquired (for the purpose of Part XII of FSMA), for example when 10 per cent or more of the shares in a UK authorised person or in their parent are held, or when 10 per cent of the voting power may be exercised in a UK authorised person or in their parent. Sections 422 (1) and (2) of FSMA define a ‘controller’ in the same way;
- section 179 (3) sets out which types of person are considered to be controllers. This includes the acquirer, any of the acquirer’s associates, or the acquirer plus any of their associates. Section 422 (4) sets out which types of person are considered to be associates. This includes spouses, children, stepchildren, trustees, employees and partner;
- section 179 (4) sets out what is regarded to be a kind of control. Four kinds of control are listed, relating to the holding of shares and the exercise of voting power. Section 422(6) and (7) respectively set out the meaning of shares and voting power.

3.6 Section 180 of FSMA specifies when a person is considered to have increased his control over a UK authorised person. In essence control is increased when the percentage of shares held in or voting powers which may be exercised in relation to a UK authorised person or in their parent increases beyond the thresholds of 20 per cent, 33 per cent and 50 per cent or when a person becomes the parent undertaking of a UK authorised person.

3.7 Section 181 of FSMA specifies when a person is considered to have reduced their control over a UK authorised person. In essence this relates to when the above-mentioned thresholds of 10 per cent, 20 per cent, 33 per cent, and 50 per cent are crossed downwards, or when a person ceases to be a parent undertaking of a UK authorised person.

3.8 Under section 192 of FSMA the Treasury may by order provide for exemptions from the obligations to report or may vary, remove or add cases in which a person is treated as being a controller or as acquiring, increasing or reducing his control.

3.9 This power has been exercised to create a simplified regime for general insurance intermediaries, whereby the 10 per cent, 20 per cent, 33 per cent and 50 per cent thresholds were replaced by a single 20 per cent threshold. SI 2003/1476 was introduced as part of the UK’s implementation of the EC Insurance Mediation Directive (2002/92/EC), and was subject to full public consultation and accompanying regulatory impact assessment. This may be found at www.hm-treasury.gov.uk/consultations_and_legislation/consult_reginsurance_mediation/consult_reginsurance_index.cfm

3.10 This power has also been used to exempt acquirers and controllers of friendly societies (SI 2001/2638) completely from the requirements in Part XII of FSMA, and to exempt the acquirers and controllers of authorised building societies (SI 2001/3338) from certain requirements in Part XII of FSMA.

4

ISSUES WITH THE CURRENT REGIME

4.1 The Treasury's consultation document 'Financial Services and Markets Act Two Year Review: Changes to Secondary Legislation' of February 2004 asked in chapter 11 whether the FSMA controllers regime would merit further consideration.

4.2 Six responses were received in relation to this specific point (from the Investment Management Association, the City of London Law Society, the Association of Private Client Investment Managers and Stockbrokers, the British Venture Capital Association, the Law Society Company Law Committee, and the Financial Services and Markets Legislation City Liaison Group).

4.3 These responses were published on the Treasury website www.hm-treasury.gov.uk/consultations_and_legislation/fsma_twoyrrev/consult_fsma2yrev_responses.cfm except where respondents indicated that they did not want their responses made public. Additional informal discussions were also held with some respondents.

4.4 Respondents raised a number of general concerns, for example that the current FSMA controllers regime is super-equivalent to EU-level requirements, burdensome, places significant compliance costs on the regulated and unregulated communities, is disproportionate with no particular benefits, and is too wide.

4.5 A range of key practical issues were also identified, including;

- the requirement to obtain approval from the FSA when seeking to take steps to acquire or increase control might not always be conducive to takeovers activity and/or might frustrate other investment decisions, especially as the FSA has three months to approve or raise objections to an increase in control. The FSA has recently introduced new guidance and directions in Handbook (Chapter 11 of the Supervision Manual) which permit pre-notification of proposed changes in control, subject to certain terms and conditions. This enables the FSA to provide prior approval for changes in control for up to twelve months;
- depositaries, custodians and nominees have little if any influence over the number of shares they hold in a particular company. In practice it might not always be possible for them to know the extent to which they hold a controlling stake in a UK authorised person. For example, decisions taken by different clients of custodians might only be known by the custodian after the event, and this could lead to reporting thresholds being crossed inadvertently;
- similarly, existing data feeds make it difficult for fund managers to determine the extent to which the firms in which they invest in turn are controllers of UK authorised persons (including whether they are associates of those who have acquired control). Many more unauthorised firms now own parts of UK authorised firms, especially following the extension of FSA regulation to mortgage advisers and general insurance intermediaries. This problem is exacerbated when fund managers make investments in non-EEA companies, especially those with complex group structures. It might not always be clear whether a UK authorised person is the subsidiary of a company in which an investment is being made;

- related to the above, parents are required aggregate the interests of their subsidiaries even if those subsidiaries have no beneficial interest in the shares they hold or control, and even if those subsidiaries owe duties concerning the exercise of any voting rights to third parties which are independent of the parent. This situation might arise in relation to fund managers, custodians, nominees or depositaries;
- where a company's constitution includes pre-emption rights on transfer, every shareholder is regarded as being a controller (because all are associates of each other), even if they hold a minimal stake, and every shareholder is regarded as controlling 100 per cent of the company. In practice some of these shareholders may hold a small interest and be of limited interest to the FSA.

4.6 In addition industry has explained that other practical difficulties arise in relation to the venture capital industry. Venture capital funds are often established in the form of limited liability partnerships, with investors having beneficial interests in the investments at hand but not influencing the voting rights attached to them and not getting involved in the running of the partnership. Currently 'controller' notifications need to be submitted to the FSA in respect of these limited partners, even though they do not hold shares or exercise voting power. Where the limited partners are other companies or investment vehicles - none of which might be authorised by the FSA - this requirement can be burdensome.

5

PROPOSED SOLUTIONS

5.1 Our proposed reforms aim to address the issues outlined above, and hence to reduce administrative and other regulatory burdens, by bringing the FSMA controllers regime closer into line with the minimum requirements of EU-level legislation. Annex A provides more details of these requirements.

Business not covered by EC Directives

5.2 As explained in paragraph 4.5, a single 20 per cent notification threshold applies in relation to general insurance intermediaries. This is consistent with the relevant underlying EC Directive in this area, the Insurance Mediation Directive (2002/92/EC). Some other business sectors are currently subject to the full-blown FSMA controllers regime yet are not required to be so on account of any EC Directives. This includes mortgage intermediaries, pre-paid funeral providers, occupational pension scheme firms, home reversion and home purchase plan providers and intermediaries, credit unions, some authorised professional firms, some commodity brokers and dealers, non-UCITS scheme operators, and some investment advisers, receivers and transmitters who do not hold client assets.

5.3 We consider that this is somewhat disproportionate, especially when viewed alongside the simplified regime which applies to general insurance intermediaries. Removing all disclosure requirements in these sectors might, however, expose investors, consumers and other third parties to risks of potential damage stemming from an objectionable change or increase in control. Industry has suggested that it might be preferable to apply a simplified regime with a single 20 per cent threshold to all business not covered by the underlying EC Directives, and this would appear to be a more proportionate way forward. As mentioned above (paragraph 3.8), under section 192 of FSMA the Treasury may by order make exemptions to the controllers regime and therefore provide for a simplified regime to apply to such non-Directive business. A more radical alternative would be not to apply the regime at all to business not covered by the underlying EC Directives

5.4 As explained in paragraph 3.10, the Treasury has already used these powers to exempt the acquirers and controllers of friendly societies from the requirements of Part XII of FSMA, and to provide a partial exemption to the acquirers and controllers of authorised building societies. We would propose to leave untouched the current complete exemption for friendly societies, but to replace the current partial exemption for authorised building societies with whatever new arrangement applies to all other non-Directive business.

Q1: Do you believe that a simplified regime should apply to all business not covered by the underlying EC Directives? Or would you favour the more radical option of not applying any regime to business not covered by the underlying EC Directives?

Q2: Do you consider that this simplified regime should consist in a single 20 per cent threshold in place of the current 10 per cent, 20 per cent, 33 per cent and 50 per cent thresholds?

Q3: Do you agree that the current complete exemption for friendly societies should remain?

Trigger for notifying the FSA

5.5 Section 178 of FSMA requires a person to notify the FSA if a step he is proposing to take would result in him acquiring, increasing, reducing or ceasing to have control over a UK authorised person. There is some ambiguity over what is involved by 'proposing to take a step'. Accordingly we would suggest removing references to 'taking a step' and simply retaining the term 'proposes'. The underlying EC Directives do not explicitly refer to 'taking a step'.

5.6 The underlying EC Directives require notification to the FSA to be made before the proposal is carried into effect rather than any earlier in the decision-making process, e.g. when an idea is first conceived. Inclusion of the term 'first' would clarify that notification should be made prior to acquiring, increasing, reducing or ceasing to have control, and is consistent with the language in the EC Directives.

Q4: Do you agree that the term 'taking a step' should be removed from section 178?

Q5: Do you agree that section 178 should include the term 'first' in order to help clarify exactly when a notification needs to be made?

Pre-notification rather than pre-approval

5.7 Under section 191 of FSMA a person commits an offence if he carries out a proposal to acquire or increase control without first having secured approval from the FSA. Under section 184(1) of FSMA the FSA may notify the person directly that their proposal has been approved. Alternatively, under section 184(2) of FSMA the FSA is treated as having issued such a notification if the FSA has not responded to the initial proposal within three months.

5.8 This FSMA requirement to secure pre-approval from the FSA is consistent with the purpose of the EC Directives which underpin the FSMA controllers regime. These EC Directives, however, do not explicitly require potential acquirers of control, or those increasing control, to secure pre-approval; instead they require pre-notification, and provide for regulatory authorities to prevent control from being exercised when the authorities hold objections. This may include the authorities preventing the exercise of voting rights, or requiring shares to be sold.

5.9 Industry has proposed that the requirement to secure explicit pre-approval from the FSA should no longer apply at the 10 per cent and 20 per cent thresholds, but should remain in relation to the other thresholds, and we would like to consult on that basis. Arguably, this approach would be more consistent with the underlying EC Directives. The acquirers of control, or those increasing control, would then need to assess for themselves whether the FSA is likely to hold objections and likely to prevent them from exercising control. The acquirers of control, or those increasing control, would bear the costs associated with any such decision by the FSA, and hence would assume the risks and implications of the FSA holding objections.

5.10 This approach would provide greater flexibility and would help reduce some of the compliance costs associated with existing arrangements. By applying this approach to the lower 10 per cent and 20 per cent thresholds only, rather than also to the 33 per cent and 50 per cent thresholds, the risks of potential damage to investors, consumers and other third parties stemming from an objectionable increase in control would be minimised. These proposals should, therefore, involve establishing a more proportionate and risk-based regime.

5.11 A more radical option would be to drop entirely the requirement for explicit pre-approval from the FSA and simply to require pre-notification. But this might provide too much scope for FSA-authorized bodies to be controlled by unsuitable persons, and might place the FSA in a weaker position to prevent harmful activities from taking place.

Q6: Do you consider that explicit pre-approval from the FSA should be sought only in relation to the higher 33 per cent and 50 per cent thresholds? Or would you favour the more radical option of dropping entirely the requirement to secure explicit pre-approval from the FSA?

Definition of controller

5.12 We suggest that the definition of ‘controller’ is brought closer into line with the requirements of the underlying EC Directives, especially as the EC Transparency Directive (2004/109/EC) provides new definitions of key terms. The deadline for transposition of this Directive is 20 January 2007.

5.13 The current definition of controller extends to cases where significant influence is held over the management of the parent undertaking of the underlying authorised person in question – even in cases where the significant influence in question does not relate to a parent undertaking being able to control or influence the underlying authorised person. We suggest that this provision, which is not supported by the underlying EC Directives is removed. This would involve deleting section 422(2)(d) and (h) of FSMA and in their place inserting a provision specifying that the significant influence must relate to the underlying authorised person; a person should continue to be regarded as a controller if they are able to exercise significant influence over the management of the authorised person by virtue of their shareholding or holding of voting power in the parent undertaking.

5.14 We would also suggest that the concept of being ‘entitled to exercise, or control the exercise of voting power’ is replaced with the simpler concept of ‘holding voting power’.

Q7: Do you agree that sections 422(2)(d) and 422(2)(h) of FSMA should be deleted and replaced with provisions relating to an interest in the parent undertaking which allows significant influence over the underlying authorised person?

Q8: Do you agree that in sections 422(2)(e) and 422(2)(g) of FSMA the term ‘is entitled to exercise, or control the exercise of’ should be replaced with the term ‘holds’ and equivalent changes be made to sections 180 and 181?

5.15 The current definition of controller refers to the concept of ‘voting power’ in relation to the authorised person in question. Article 10 of the EC Transparency Directive (2004/109/EC) provides a new definition of ‘voting power’, which captures cases where control over an authorised person is held both directly and indirectly.

5.16 This new definition of ‘voting power’ seems to render certain aspects of the current concept of an ‘associate’ redundant. This concept ‘associate’ sought to capture indirect control, but is not explicitly provided for in EU-level legislation, and also captures what appears to be a disproportionately broad range of relationships.

Q9: Do you agree that the FSMA controllers regime should adopt the new definition of ‘voting power’ provided by Article 10 of the EC Transparency Directive (2004/109/EC)?

Q10: Do you consider that if this new definition of ‘voting power’ is adopted then the case for retaining the concept of an ‘associate’ is weak, i.e. that sections 422(3), 422(4) and 422(5) should be deleted?

5.17 Custodians, nominees and other bare trustees hold shares passively on behalf of other persons, without themselves exercising any control or influence over the body to which the shares relate. They are not the beneficial owners of the shares in question and information on the levels of their shareholdings is of relatively limited interest to the FSA, at least from the perspective of the FSMA controllers regime.

5.18 Accordingly, the FSA has introduced simplified requirements for these parties via its handbook of rules. Those subject to the simplified requirements still need to abide by the existing FSMA requirements, however, and these outstanding reporting requirements generate administrative burdens. The underlying EC Directives do not explicitly seek to capture these kinds of nominal shareholdings.

5.19 Article 9 of the EC Transparency Directive (2004/109/EC) explicitly exempts custodians from the notification requirements of that Directive, and also explicitly exempts the ownership of shares which are held for the purpose of clearing and settling within the usual short settlement cycle. We would propose to include these specific exemptions in the revised definition of ‘controller’.

5.20 Whilst we have considered providing an additional explicit exemption for nominees and other bare trustees, in the recent High Court case of *Re Kilnoore* (EWHC 1410, 2005) the court held that bare trustees and nominees are not to be regarded as being caught by provisions relating to those who exercise or control the exercise of voting power. Applying this principle to the FSMA controllers regime would suggest that they would not fall within the definition of ‘controller’, and as such there is already no need for these parties to make notifications to the FSA under the FSMA controllers regime. If an express exemption was provided for nominees and bare trustees this might imply that in other legislation, where there is currently no express exemption, nominees and bare trustees might fall within any equivalent definition of controller. For these reasons we believe it is unnecessary to introduce a new explicit exemption for bare trustees and nominees.

5.21 A person exercising votes by proxy at a meeting on behalf of others might also happen to cross one of the FSMA controllers regime reporting thresholds, even though the strength of the voting power which they themselves hold might fall below the relevant threshold. The same applies to persons appointed to act as corporate representatives. It might not be practical or proportionate to require such persons to secure prior approval from the FSA before exercising these votes. Whilst such persons might be ‘entitled to exercise, or control the exercise of’ voting power held by others, we consider that they themselves should not be regarded as ‘holding’ others’ voting power. The proposed new wording of sections 422(2)(e) and 422(2)(g) of FSMA (see Q8 above) should, therefore, ensure that notifications are not needed in these circumstances.

Q11: Do you consider that custodians and shares acquired for the sole purpose of clearing and settling should be given an explicit exemption from the definition of ‘controller’?

Q12: Do you agree that bare trustees and nominee shareholders do not need to be given an explicit exemption from the definition of ‘controller’ because they already fall outside this definition by virtue of case law?

Q13: Do you believe that there is no need to provide an explicit exemption for persons exercising voting rights by proxy, including corporate representatives, given the proposed changes to sections 422(2)(e) and 422(2)(g)? (see Q8).

Unifying existing FSMA provisions

5.22 Sections 179(2) and 422(2) of FSMA both set out when a person is considered to have acquired control of a UK authorised person, and much of the text of these two sections is shared. It would be simpler to adopt a unified text, for example if section 179 of FSMA incorporated by reference the provisions of section 422 of FSMA, amended as proposed above.

Q14: Do you agree that it would be preferable for FSMA to provide a single definition of ‘controller’, placed in Part XII of FSMA alongside the other aspects of the FSMA controllers regime?

Close links

5.23 Under paragraph 3 of Schedule 6 of FSMA the FSA is required to be satisfied that if an authorised person has ‘close links’ with another person, then those close links or any overseas (non-EEA) provisions relating to that other person should not prevent the FSA’s effective supervision of the authorised person. Paragraph 3 of Schedule 6 of FSMA defines what it means to have ‘close links’.

5.24 Industry has drawn comparisons between the FSMA controllers regime and between the reporting requirements associated with the ‘close links’ regime, including whether the current ‘close links’ provisions exceed the minimum requirements of the relevant underlying EC Directives.

Q15: Views would be welcome on whether, and if so how, the ‘close links’ regime might be simplified in line with the requirements of EU-level legislation.

6

PARTIAL REGULATORY IMPACT ASSESSMENT

TITLE OF THE PROPSAL

6.1 The Financial Services and Markets Act 2000 (Amendment) (Controllers) Regulations 2006.

PURPOSE AND INTENDED EFFECT

6.2 The objective of the changes introduced by these regulations is to establish a more proportionate regime for requiring persons (both authorised and unauthorised) to notify the Financial Services Authority (FSA) in writing if they acquire, increase or reduce their control over a UK authorised person. The current regime, which stems from provisions in Part XII of the Financial Services and Markets Act 2000 (FSMA), results in a large number of reports being filed with the FSA in a wide range of circumstances.

6.3 The regulatory value of information contained in these reports can be variable, the volume of reports can be burdensome on industry to produce, and it is becoming increasingly difficult in some circumstances to comply with some of the existing requirements. This is due in part to changing patterns of ownership and to the extension of FSA regulation to mortgage advisers and general insurance intermediaries.

6.4 This objective of establishing a more proportionate regime will be achieved by amending the definition of what it means to exercise control over a UK authorised person. The reformed reporting regime should continue to provide the FSA with information needed for their regulatory operations and responsibilities but lead to a reduction in the volume of disclosures which are of relatively less regulatory value. The new requirements should be easier and cheaper to comply with.

6.5 In particular, the changes introduced by this secondary legislation seek to bring the requirements of Part XII of FSMA closer into line with the requirements of underlying EC Directives. The changes achieve this by:

- applying a simplified regime to business not subject to the relevant reporting requirements stemming from EC Directives;
- requiring the FSA to be notified only where a person proposes to acquire, increase or reduce their control over a UK authorised person, rather than (as now) where a person proposes to ‘take a step’ in this direction;
- removing the need to secure pre-approval from the FSA before acquiring lower degrees of control (i.e. the 10 per cent and 20 per cent thresholds relating to share ownership and voting power);
- reducing the need to make disclosures to the FSA in relation to parent undertakings, and clarifying that disclosures only need to be made when voting rights are ‘held’;
- introducing a simplified definition of ‘controller’, in the process dropping the concepts of ‘kinds of control’ and an ‘associate’ and providing a new definition of ‘voting power’; and

- providing an exemption for custodians and for shares acquired for the sole purpose of clearing and settling.

6.6 Those affected most by the changes will be those persons who routinely make a large number of reports to the FSA, especially where this includes reports of relatively less regulatory value to the FSA. Persons finding it difficult or costly to comply with aspects of the current regime should also benefit more significantly than others. Depositaries, custodians and nominees (including asset managers) are more likely to fall into these categories.

BACKGROUND

6.7 The existing reporting requirements stem from section 178 of FSMA, which requires a person to notify the FSA if a step they are proposing to take would result in them acquiring control, acquiring an additional kind of control, or increasing a relevant kind of control over a UK authorised person. This requirement to notify the FSA applies to all persons, not just to persons authorised by the FSA. Section 190 of FSMA requires a person to notify the FSA if a step they are proposing to take would result in them ceasing to have control of a relevant kind, or reducing a relevant kind of control over a UK authorised person.

6.8 Notifications of an acquisition or increase in control must be submitted to the FSA in writing and must include such information and documentation as required by the FSA. Within three months of receiving such notifications the FSA must decide whether to approve the change in control, to attach conditions to the change of control, or to warn that it proposes to object to the change of control.

6.9 Sections 179 and 422 of FSMA both set out eight instances in which control is considered to have been acquired. This includes where control may be exercised by holding voting rights, by holding capital, or by exercising significant influence over the management of the authorised person in question. These criteria also apply to the parent undertaking of the authorised person in question.

6.10 Section 179 sets out which types of person are considered to be controllers. This includes the acquirer of control, any of their associates, or the acquirer plus any of their associates. Section 422 of FSMA sets out which types of person are considered to be associates. This definition includes a wide range of relations and in part is responsible for the large volume of reports which are filed under the regime.

6.11 Section 179 of FSMA sets out what is regarded to be a kind of control. Four kinds of control are listed, including the exercise of voting power and the holding of shares. Section 422 of FSMA in addition sets out the meaning of shares and voting power.

6.12 Section 180 of FSMA sets out when a person is considered to have increased their control over a UK authorised person, and section 181 of FSMA sets out when a person is considered to have reduced their control over a UK authorised person. In both cases this relates to when the percentage of shares held or voting powers exercised crosses thresholds of 10 per cent, 20 per cent, 33 per cent and 50 per cent. Under SI 2003/1476 a simplified regime was applied to general insurance intermediaries, whereby these four thresholds were replaced by a single 20 per cent threshold. Exemptions from certain requirements in Part XII are also applied to controllers of friendly societies (SI 2001/2638) and authorised building societies (SI 2001/3338).

RATIONALE FOR INTERVENTION

6.13 The rationale for intervention and purpose of changing the current regime is to introduce better targeted, more proportionate and more flexible requirements which are easier and cheaper to comply with, and which present the FSA with the information they need to fulfil their regulatory objectives efficiently, economically and effectively.

6.14 The current regime requires a large volume of reports to be filed. Between 1 January 2005 and 30 September 2005 829 notifications were received by the FSA, broken down as follows:

- 531 applications (64 per cent) to become a new controller;
- 132 applications (16 per cent) relating solely to mortgage advice and general insurance business;
- 72 applications (9 per cent) from fund managers wishing only to take up more than 20 per cent of control;
- 38 applications (5 per cent) from those wishing to decrease their existing control (moving between bands of control);
- 31 applications (4 per cent) from those wishing to increase their existing control (moving between bands of control);
- 25 applications (3 per cent) where there is no change in control (an increase or decrease in ownership but no change in the band of control).

6.15 In addition to these concerns about the regulatory benefits of some reports, other concerns have surfaced about the increasing costs of complying with the existing reporting requirements. In particular, current data feeds make it very difficult for fund managers to determine the extent to which the firms in which they invest in turn are controllers of UK authorised persons, especially following the extension of FSA regulation to mortgage advisers and general insurance intermediaries, and also when investments are made in non-EEA companies with complex group structures.

6.16 In terms of enforceability, depositaries, custodians and nominees have little influence over the number of shares they hold in a particular company, and it might not always be possible for them to know exactly how much of a controlling stake they hold over a UK authorised person, or such information might only be known after one of the relevant thresholds has been crossed rather than before.

CONSULTATION

6.17 The February 2004 consultation document Financial Services and Market Act: Two Year Review: Changes to Secondary Legislation invited views, amongst other issues, on whether it would be desirable to review these provisions in Part XII of FSMA. Six responses were received on this issues, and all supported reforming the current FSMA requirements to make them more proportionate. Following this consultation exercise the Treasury consulted informally with the FSA and with some of the consultation respondents in order to devise proposed reforms.

6.18 This Partial RIA lays out the implementation options for the reforms to Part XII of FSMA highlighted above and considers the costs and benefits. Risks, unintended consequences, any compliance and enforcement issues, competition issues and the impact on small firms have also been considered.

6.19 When formally responding to the Partial RIA we are seeking comments on the analysis of costs and benefits, likely risks and unintended consequences of the proposed options, as well as supporting evidence wherever possible. If you feel there are alternative options, or indeed alternative combinations of existing options, please suggest these. The feedback to this Partial RIA will provide valuable information which will feed into the Final RIA following this consultation. The consultation document and Partial RIA should be read together.

OPTIONS

Do nothing

6.20 Without legislative change the current reporting regime would remain as it is. The problems associated with the current regime would remain, as outlined in paragraphs 6.15 to 6.16, and the risks of possible detriment outlined in paragraphs 6.25 to 6.29 would materialise.

Non legislative-options

6.21 The current provisions of FSMA provide limited scope for non-legislative solutions. The FSA has already introduced new guidance and directions in its handbook of rules (Chapter 11 of the Supervision Manual) which permit pre-notification of proposed changes of control, subject to certain terms and conditions. This enables the FSA to provide prior approval for changes in control for up to twelve months.

6.22 Although FSA guidance and rules are able to provide for such pre-notification they are not able to provide for any lightening of the current provisions in FSMA.

Legislation

6.23 Amending the existing FSMA provisions is the only way of altering the current reporting requirements. Under section 192 of FSMA the Treasury is able by order to provide for exemptions from the requirements to make notifications to the FSA, and is able to vary or remove any of the cases in which a person is regarded as being a controller or regarded as acquiring, increasing or reducing control.

6.24 In addition section 2(2) of the European Communities Act 1972 enables the Treasury to make statutory instruments to amend FSMA for the sake of implementing EC Directives. Part XII of FSMA gives effect to provisions in various EC Directives concerning financial services. The EC Directives in question are Directives 85/611/EEC on undertakings for collective investment in transferable securities, as amended by 2001/107/EC; 92/49/EEC on non-life insurance; 93/22/EEC on investment services; 2000/12/EC, the banking consolidation Directive; 2002/83/EC, the consolidated life assurance Directive and 2004/39/EC, on markets in financial instruments. These powers under section 2(2) of the European Communities Act 1972 provide the Treasury with more scope to amend the existing reporting requirements in FSMA than the powers under section 192 of FSMA, and have been used to make the regulations to which this regulatory impact assessment relates.

RISK ASSESSMENT

6.25 There are potential risks that the current reporting regime will become increasingly difficult and costly to comply with in the future as patterns of ownership become more complex, especially given trends towards increasing cross-border ownership. Difficulties already apply in some sectors, especially in relation to asset managers, custodians and depositaries.

6.26 The potential risks of non-compliance have been increased by the recent extension of FSA regulation to cover mortgage advisers and general insurance intermediaries, many of which are small firms. This extension of FSA regulation provides more scope for people to acquire, increase or decrease their control over UK authorised persons. Many such controllers, and their associates, may themselves not be UK authorised persons and may be unaware of their obligations to notify the FSA. Failure to satisfy the reporting requirements set out in FSMA is an offence and penalties include the application of fines and also imprisonment if FSA warning notices are ignored.

6.27 In addition to risks of non-compliance, there are potential risks that the current reporting regime will leave controllers with disproportionate compliance burdens, especially if information which is more costly to acquire and report to the FSA is of relatively less regulatory value to the FSA.

6.28 There are risks that if a more proportionate reporting regime is established this might lead to the unintended consequence of the FSA not obtaining all the information it needs in order to ensure that those controlling UK authorised persons are fit and proper, and that their control does not threaten the interests of consumers.

6.29 In order to mitigate these risks current FSMA requirements are being amended to introduce a more proportionate and better targeted reporting regime, which should ensure that the FSA continues to receive information it needs to fulfil its responsibilities.

COSTS AND BENEFITS

Costs

6.30 The FSA may incur one-off costs in amending rules, guidance and codes in accordance with the new requirements, and FSA staff (e.g. based in the contact centres) may incur one-off costs in learning about the new requirements. These costs are unlikely to be significant and are difficult to quantify meaningfully. Equally those who are required to make reports to the FSA may incur one-off costs as a result of familiarising themselves with the new requirements, but these costs are unlikely to be significant and are difficult to quantify.

6.31 It is possible that the new requirements may generate a demand for more guidance from the FSA, e.g. in relation to how the new provisions are to be interpreted. But this is likely to be offset by a reduction in demand for guidance in relation to ambiguous elements of the current regime which will be dropped, e.g. the concept of 'taking a step'.

Benefits

6.32 The FSA currently receives around 1150 reports per year. It is difficult to quantify the average cost of submitting each report, and to quantify the likely reduction in reporting volumes. If each report costs on average between £500 and £2500 to submit and the volume of reports drops by 10 per cent to 20 per cent then compliance savings of between £60,000 and £575,000 per year would be generated.

6.33 These direct industry compliance costs relate to:

- compliance staff costs, including the preparation and collection of material, and the costs of managerial supervision;
- legal costs for advice on the requirements of Part XII of FSMA. This would include advice on whether notifications need to be made, and what needs to be included in them. Such advice is often necessary in order to avoid committing an offence under FSMA;
- costs of data collection, including IT system costs;
- external IT costs relating to the identification of relevant corporate parent-subsubsidiary relationships;
- administrative costs of completing FSA forms

6.34 In addition the reforms associated with this secondary legislation should minimise a range of business impact costs, many of which are likely to be more significant than the direct business compliance costs outlined above, but more difficult to quantify. These include:

- problems for tracker funds trying to maintain the mandated balance within the funds;
- interference with fund managers' discretion to take advantage of short term buying opportunities;
- restrictions on the ability to implement portfolio models consistency;
- restrictions on the effective hedging of risks;
- disruption to market-making activities;
- interference with proprietary trading strategies or preventing proprietary traders from reacting effectively to market events;
- restrictions on the ability to close out short positions or borrow against a short position;
- restrictions on equities and future portfolio trading, which may subsequently have a wider impact on trading beyond the immediate trading in the stock itself;
- restrictions on discretionary private client trading;
- interference with the facilitation of client flow;
- interference with transition accounts.

SMALL FIRMS IMPACT TEST

6.35 The reduced reporting requirements introduced by these regulations are unlikely to have a significant effect on small firms, unless those small firms are required to report to the FSA that they hold a controlling relationship over a UK authorised person. Most small firms do not hold such relationships. The fact that small firms authorised by the FSA might be the subject of notifications does not place a regulatory burden on them.

COMPETITION ASSESSMENT

6.36 No impact is foreseen on the position of individual firms, in the sense that the changes apply to all those engaged in particular activities and are not specific to individual firms. Competition between firms in different business sectors (e.g. banking, investment services) is unlikely to be affected by the changes introduced by these regulations. By reducing the costs of complying with FSA regulation these changes should, at the margin, reduce entry costs and hence promote increased competition. These effects are likely to apply most in those business sectors where the changes are likely to have the most beneficial impacts, e.g. to asset managers, custodians, and depositaries. Increased competition with firms subject to overseas financial regulation is also likely to result from these changes, which bring the requirements of UK regulation closer into line with the minimum requirements of EC Directives.

ENFORCEMENT, SANCTIONS AND MONITORING

6.37 Compliance with the current provisions in FSMA, once modified by these changes, will continue to be monitored and enforced by the FSA. Under section 183 of FSMA the FSA is required, within three months of receiving a notice of control, to approve in writing the change of control or to serve a warning notice. Failure to do so is regarded as providing approval.

6.38 Section 185 of FSMA allows the FSA to attach conditions to its approval of control, and sections 186 and 187 of FSMA allow the FSA to object to the acquisition of control or to object to existing control, for example if the controller is not fit and proper to have control or if the interests of consumers would be threatened by their possessing control. In all cases when exercising these powers the FSA is required under FSMA to issue a warning notice first, followed by a decision notice.

6.39 Section 189 of FSMA enables the FSA to place restrictions on shares which have been acquired improperly, e.g. acquired in contravention of a condition or objection made by the FSA. Under section 189 of FSMA the FSA may also obtain a court order requiring such shares to be sold. Section 191 of FSMA sets out which penalties apply to persons guilty of an offence for not complying with an FSA warning notice or decision notice.

IMPLEMENTATION AND DELIVERY PLAN

6.40 Changes to the existing provisions in FSMA will be implemented by the FSA, such as the current reporting regime is implemented by the FSA. Changes will involve lightening existing requirements and should be straightforward to implement. The FSA will bring the new requirements to public attention via the same means that the FSA brings other FSMA requirements to public attention, and this may involve producing new rules, guidance and codes.

POST-IMPLEMENTATION REVIEW

6.41 The impact of these changes will be kept under close review in order to ensure that the right balance has been struck between enabling the FSA to meet its statutory objectives and responsibilities economically, efficiently and effectively, and ensuring that persons are not unduly burdened by requirements to make reports to the FSA. A formal public review at a fixed point in the future is not planned at this stage. Instead the Treasury wishes to retain a flexible approach towards reviewing and amending aspects of the reporting regime as and when desirable.

SUMMARY AND RECOMMENDATIONS

6.42 Existing requirements in FSMA for any person to notify the FSA when they acquire control over a UK authorised person and/or when the level of their control increases or reduces are becoming increasingly difficult and costly to comply with, particularly for certain types of body (asset managers, custodians, depositaries). It is unclear whether the costs of filing some of these reports is always justified by the regulatory benefits.

6.43 Accordingly a more proportionate, more flexible and better targeted regime is being introduced which should result in the FSA continuing to receive reports which are of sufficiently high regulatory value. This will be achieved in part by bringing the existing regime closer into line with the requirements of EC Directives.

A.1 The FSMA controllers regime gives effect to provisions in various EC Directives. In each of the EC Directives the provisions are in a similar form. The following example is taken from 2000/12/EC the 'Banking Consolidation Directive'.

Article 1(10)

“Qualifying holding” shall mean a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which a holding subsists.

Article 16

Qualifying holding in a credit institution:

- the Member States shall require any natural or legal person who proposes to hold, directly or indirectly a qualifying holding in a credit institution first to inform the competent authorities, telling them of the size of the intended holding. Such a person must likewise inform the competent authorities if he proposes to increase his qualifying holding so that the proportion of the voting rights or of the capital held by him would reach or exceed 20%, 33% or 50% or so that the credit institution would become his subsidiary. Without prejudice to the provisions of paragraph 2, the competent authorities shall have a maximum of three months from the date of the notification provided for in the first subparagraph to oppose such a plan if, in view of the need to ensure sound and prudent management of the credit institution, they are not satisfied as to the suitability of the person referred to in the first subparagraph. If they do not oppose the plan referred to in the first subparagraph, they may fix a maximum period for its implementation;
- if the acquirer of the holdings referred to in paragraph 1 is a credit institution authorised in another Member State or the parent undertaking of a credit institution authorised in another Member State or a natural or legal person controlling a credit institution authorised in another Member State and if, as a result of that acquisition, the institution, in which the acquirer proposes to hold a holding would become a subsidiary or subject to the control of the acquirer, the assessment of the acquisition must be the subject of the prior consultation referred to in Article 12;
- the Member States shall require any natural or legal person who proposes to dispose, directly or indirectly, of a qualifying holding in a credit institution first to inform the competent authorities, telling them of the size of his intended holding. Such a person must likewise inform the competent authorities if he proposes to reduce his qualifying holding so that the proportion of the voting rights or of the capital held by him would fall below 20%, 33% or 50% or so that the credit institution would cease to be his subsidiary;

- on becoming aware of them, credit institutions shall inform the competent authorities of any acquisitions or disposals of holdings in their capital that cause holdings to exceed or fall below one of the thresholds referred to in paragraphs 1 and 3. They shall also, at least once a year, inform them of the names of shareholders and members possessing qualifying holdings and the sizes of such holdings as shown, for example, by the information received at the annual general meetings of shareholders and members or as a result of compliance with the regulations relating to companies listed on stock exchanges;
- the Member States shall require that, where the influence exercised by the persons referred to in paragraph 1 is likely to operate to the detriment of the prudent and sound management of the institution, the competent authorities shall take appropriate measures to put an end to that situation. Such measures may consist for example in injunctions, sanctions against directors and managers, or the suspension of the exercise of the voting rights attaching to the shares held by the shareholders or members in question. Similar measures shall apply to natural or legal persons failing to comply with the obligation to provide prior information, as laid down in paragraph 1. If a holding is acquired despite the opposition of the competent authorities, the Member States shall, regardless of any other sanctions to be adopted, provide either for exercise of the corresponding voting rights to be suspended, or for the nullity of votes cast or for the possibility of their annulment;
- for the purposes of the definition of qualifying holding and other levels of holding set out in this Article, the voting rights referred to in Article 7 of Directive 88/627/EEC shall be taken into consideration.” With the coming into force of the directive 2004/109/EC, the ‘Transparency Directive’, the reference to ‘Directive 88/627/EEC’ is to be read as a reference to the Transparency Directive.

With the coming into force of the Directive 2004/109/EC, the ‘Transparency Directive’, the reference to ‘Directive 88/627/EEC’ is to be read as a reference to the Transparency Directive.



PROPOSED LEGISLATION

Draft Regulations laid before Parliament under section 2(2) of the European Communities Act 1972, for approval by resolution of each House of Parliament.

DRAFT STATUTORY INSTRUMENTS

2006 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Controllers) Regulations 2006

Made - - - - ***
Coming into force - - ***

The Treasury are a government department designated⁽¹⁾ for the purposes of section 2(2) of the European Communities Act 1972⁽²⁾ in relation to credit and financial institutions.

The Treasury, in exercise of the powers conferred upon them by section 2(2) of the European Communities Act 1972, make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Financial Services and Markets Act 2000 (Controllers) Regulations 2006 and come into force on [***].

Amendments to the Financial Services and Markets Act 2000

2. The Financial Services and Markets Act 2000⁽³⁾ is amended as follows.

3. In section 178 (obligation to notify the Authority)—

(a) for subsections (1) and (2) substitute—

“(1) If a person proposes to acquire—

- (a) control over a UK authorised person, or
- (b) an increase in control over a UK authorised person,

he must first notify the Authority of his proposal.

(2) If a person acquires—

- (a) control over a UK authorised person, or

¹ See the European Communities (Designation) (No.3) Order 2001 (S.I. 2001/3495).

⁽²⁾ 1972 c.68.

⁽³⁾ 2000 c.8.

- (b) an increase in control over a UK authorised person,

in circumstances where he is not required to give notice under subsection (1), he must notify the Authority before the end of the period of 14 days beginning with the day on which he first becomes aware that he has acquired it.”; and

- (b) omit subsection (3).

4. For section 179 (acquiring control) substitute—

“Acquiring control

179. For the purposes of this Part, a person acquires control over a UK authorised person on becoming a controller of the authorised person.”.

5. In section 180 (increasing control)—

- (a) in paragraphs (c) and (d) of subsection (1) for “which the controller is entitled to exercise, or control the exercise of,” substitute “held by the controller”;
- (b) for subsection (3) substitute—
- “(3) For the purposes of this section and section 181, “shares” and “voting power” have the same meaning as in section 422.”; and
- (c) omit subsection (4).

6. In section 181 (reducing control)—

- (a) in subsection (1)—
- (i) in paragraphs (c) and (d) for “which the controller is entitled to exercise, or control the exercise of,” substitute “held by the controller”; and
- (ii) for “the controller ceases to have the kind of control concerned” substitute “he ceases to have control”; and
- (b) omit subsection (3).

7. After section 181 (reducing control) insert—

“Ceasing to have control

181A. For the purposes of this Part, a person ceases to have control over a UK authorised person on ceasing to be a controller of the authorised person.”.

8. In subsection (1) of section 186 (objection to acquisition of control) for “acquiring control” substitute “acquiring the control in question”.

9. In subsection (2) of section 187 (objection to existing control) omit “If the failure relates to subsection (1) or (2) of that section,”.

10. In section 189 (improperly acquired shares)—

- (a) in subsection (7)—
- (i) in paragraphs (a)(ii), (b) and (c)(i) omit “or an associate of his”; and
- (ii) omit “(or an associate of his)”; and
- (b) for subsection (8) substitute—
- “(8) A copy of the restriction notice must be served on the authorised person to whose shares it relates.”.

11. In section 190 (notification)—

- (a) for subsection (1) substitute—
- “(1) If a controller of a UK authorised person proposes to—
- (a) cease to have control over the authorised person, or
- (b) reduce his control over that person,
- he must first notify the Authority of his proposal.”;

- (b) in subsection (2) for “without himself taking any such step” substitute “in circumstances where he is not required to give notice under subsection (1)”; and
- (c) omit subsection (3).

12. In section 191 (offences under this Part)—

- (a) at the beginning of subsection (3) insert “Subject to subsection (3A),”;
- (b) after subsection (3) insert—
 - “(3A) A person does not commit an offence under subsection (3) if, as a result of carrying out the proposal to which the notice relates, the person holds less than 33% of the shares or voting power in—
 - (a) the UK authorised person to which the notice relates; or
 - (b) a parent undertaking of the UK authorised person.”; and
- (c) omit subsections (10) and (11).

13. For paragraph (b) of section 192 (power to change definitions of control etc) substitute—

“(b) amend section 179 by varying the circumstances in which a person is treated as having control over a UK authorised person;”.

14. In section 422 (controller)—

- (a) in subsection (1) after “person” insert “(other than a custodian)”;
- (b) in subsection (2)—
 - (i) for paragraph (d) substitute—
 - “(d) is able to exercise significant influence over the management of A by virtue of his shareholding in P;”;
 - (ii) in paragraphs (e) and (g) for “is entitled to exercise, or control the exercise of,” substitute “holds”; and
 - (iii) for paragraph (h) substitute—
 - “(h) is able to exercise significant influence over the management of A by virtue of his voting power in P;”;
- (c) for subsections (3) and (4) substitute—
 - “(3) For the purposes of subsection (2), shares acquired for the sole purposes of clearing and settling within a short settlement cycle are to be disregarded.
 - (4) “Custodian” means a person who—
 - (a) holds shares in a custodian capacity, and
 - (b) can only exercise the voting power attached to such shares under instructions given in writing or by electronic means.”;
- (d) omit subsection (5); and
- (e) for subsection (7) substitute—
 - “(7) “Voting power”—
 - (a) includes, in relation to a person (“H”)—
 - (i) voting power held by a third party with whom H has concluded an agreement, which obliges H and the third party to adopt, by concerted exercise of the voting power they hold, a lasting common policy towards the management of the undertaking in question;
 - (ii) voting power held by a third party under an agreement concluded with H providing for the temporary transfer for consideration of the voting power in question;
 - (iii) voting power attaching to shares which are lodged as collateral with H, provided that H controls the voting power and declares his intention of exercising it;
 - (iv) voting power attaching to shares in which H has the life interest;
 - (v) voting power which is held, or may be exercised within the meaning of sub-paragraphs (i) to (iv), by an undertaking controlled by H;

- (vi) voting power attaching to shares deposited with H which H can exercise at his discretion in the absence of specific instructions from the shareholders;
 - (vii) voting power held by a third party in his own name on behalf of H; and
 - (viii) voting power which H may exercise as a proxy where H can exercise the voting power at his discretion in the absence of specific instructions from the shareholders; and
- (b) in relation to an undertaking which does not have general meetings at which matters are decided by the exercise of voting rights, means the right under the constitution of the undertaking to direct the overall policy of the undertaking or alter the terms of its constitution.”.

Names

Two of the Lords Commissioners of Her Majesty's Treasury

th 2006

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Financial Services and Markets Act 2000 (c.8) (“the Act”). The amendments relate to Part 12 (control over authorised persons) and definitions in section 422 (controller).

Part 12 of the Act regulates persons with holdings in UK authorised firms in the financial sector in order to ensure that any person with a controlling holding is a fit and proper person and that there is no threat to consumers’ interests.

Part 12 gives effect to provisions in various EC Directives concerning financial services. These are directives 85/611/EEC on undertakings for collective investment in transferable securities (O.J. No. L375, 31.12.1985, p.3), as amended by 2001/107/EC (O.J. No. L41, 13.2.2002 p.20); 2000/12/EC, the banking consolidation directive (O.J. No. L126, 26.5.2000, p.1); 92/49/EEC on non-life insurance (O.J. No. L228, 11.8.1992 p.1); 2002/83/EC, the consolidated life assurance directive (O.J. No. L345, 19.12.2002, p.1) and 93/22/EEC on investment services (O.J. No. L141, 11.6.1993 p.27), to be superseded by 2004/39/EC on markets in financial instruments (O.J. No. L145, 30.4.2004, p.1).

These Regulations amend the Act as follows.

Regulation 3 amends section 178 (obligation to notify the Authority) in order to simplify the circumstances in which a person has to notify the Financial Services Authority. The provisions no longer include reference to the notions of “taking a step”, “kinds of control” or “an associate”.

Regulations 4, 5 and 6 make related amendments to sections 179 (acquiring control), 180 (increasing control) and 181 (reducing control).

Regulation 7 inserts a new provision to clarify when, for the purposes of Part 12, a person ceases to have control over a UK authorised person.

Regulations 8 to 11 amend sections 186 (objection to the acquisition of control), 187 (objection to existing control), 189 (improperly acquired shares) and 190 (notification) in order to ensure consistency with the other amended provisions.

Regulation 12 inserts a new provision into section 191 (offences under this Part), so as to enable a person, subject to certain limits, to carry out a proposal to acquire or increase control of a UK authorised person after he has given notice but before the Authority responds substantively.

Regulation 13 amends section 192 (power to change definitions of control etc) to reflect the changes to the provisions in section 179.

Regulation 14 amends the definition of “controller” in section 422 in order to simplify the circumstances in which a person is a “controller” and to remove the notion of “associate”. Amendments are also made to ensure that the provisions are consistent with directive 2004/109/EC, the Transparency Directive (O.J. No. L390, 31.12.2004, p.38). Custodians are excluded, shares acquired for the sole purposes of clearing and settling within a short settlement cycle are to be disregarded and the definition of “voting power” is amended.

A partial regulatory impact assessment of the effect of this instrument on the costs of business may be obtained from the Financial Stability and Regulatory Policy Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ and is available on the Treasury's website (www.hm-treasury.gov.uk).

CONTROL OVER AUTHORISED PERSONS

CHAPTER 1

Notice of control

178. – (1) If a person proposes to acquire—
 (a) control over a UK authorised person, or
 (b) an increase in control over a UK authorised person,
 he must first notify the Authority of his proposal.

(2) If a person acquires—
 (a) control over a UK authorised person, or
 (b) an increase in control over a UK authorised person,

in circumstances where he is not required to give notice under subsection (1), he must notify the Authority before the end of the period of 14 days beginning with the day on which he first becomes aware that he has acquired it.

[(3). ...]

(4) In this Part "UK authorised person" means an authorised person who-

(a) is a body incorporated in, or an unincorporated association formed under the law of, any part of the United Kingdom; and

(b) is not a person authorised as a result of paragraph 1 of Schedule 5.

(5) A notice under subsection (1) or (2) is referred to in this Part as "a notice of control".

Acquiring, increasing and reducing control

Acquiring control

179. - For the purposes of this Part a person acquires control over a UK authorised person upon becoming a controller of the authorised person.

180. - (1) For the purposes of this Part, a controller of a person ("A") who is a UK authorised person increases his control over A if-

(a) the percentage of shares held by the controller in A increases by any of the steps mentioned in subsection (2);

(b) the percentage of shares held by the controller in a parent undertaking ("P") of A increases by any of the steps mentioned in subsection (2);

(c) the percentage of voting power held by the controller in A increases by any of the steps mentioned in subsection (2);

(d) the percentage of voting power held by the controller in P increases by any of the steps mentioned in subsection (2); or

(e) the controller becomes a parent undertaking of A.

(2) The steps are-

(a) from below 10% to 10% or more but less than 20%;

(b) from below 20% to 20% or more but less than 33%;

(c) from below 33% to 33% or more but less than 50%;

(d) from below 50% to 50% or more.

(3) For the purposes of this section and section 181, “shares” and “voting power” have the same meaning as in section 422.

[(4). ...]

181. - (1) For the purposes of this Part, a controller of a person ("A") who is a UK authorised person reduces his control over A if-

- (a) the percentage of shares held by the controller in A decreases by any of the steps mentioned in subsection (2),
- (b) the percentage of shares held by the controller in a parent undertaking ("P") of A decreases by any of the steps mentioned in subsection (2),
- (c) the percentage of voting power held by the controller in A decreases by any of the steps mentioned in subsection (2),
- (d) the percentage of voting power held by the controller in P decreases by any of the steps mentioned in subsection (2), or
- (e) the controller ceases to be a parent undertaking of A.

(2) The steps are-

- (a) from 50% or more to 33% or more but less than 50%;
- (b) from 33% or more to 20% or more but less than 33%;
- (c) from 20% or more to 10% or more but less than 20%;
- (d) from 10% or more to less than 10%.

[(3). ...]

Ceasing to have control

181A. - For the purposes of this Part, a person ceases to have control over a UK authorised person upon no longer being a controller of the authorised person.

Acquiring or increasing control: procedure

182. - (1) A notice of control must-

- (a) be given to the Authority in writing; and
- (b) include such information and be accompanied by such documents as the Authority may reasonably require.

(2) The Authority may require the person giving a notice of control to provide such additional information or documents as it reasonably considers necessary in order to enable it to determine what action it is to take in response to the notice.

(3) Different requirements may be imposed in different circumstances.

183. - (1) The Authority must, before the end of the period of three months beginning with the date on which it receives a notice of control ("the period for consideration"), determine whether-

- (a) to approve of the person concerned having the control to which the notice relates; or
- (b) to serve a warning notice under subsection (3) or section 185(3).

(2) Before doing so, the Authority must comply with such requirements as to consultation with competent authorities outside the United Kingdom as may be prescribed.

(3) If the Authority proposes to give the person concerned a notice of objection under section 186(1), it must give him a warning notice.

184. - (1) If the Authority decides to approve of the person concerned having the control to which the notice relates it must notify that person of its approval in writing without delay.
(2) If the Authority fails to comply with subsection (1) of section 183 it is to be treated as having given its approval and notified the person concerned at the end of the period fixed by that subsection.

(3) The Authority's approval remains effective only if the person to whom it relates acquires the control in question-

- (a) before the end of such period as may be specified in the notice; or
- (b) if no period is specified, before the end of the period of one year beginning with the date-
 - (i) of the notice of approval;
 - (ii) on which the Authority is treated as having given approval under subsection (2); or
 - (iii) of a decision on a reference to the Tribunal which results in the person concerned receiving approval.

185. - (1) The Authority's approval under section 184 may be given unconditionally or subject to such conditions as the Authority considers appropriate.

- (2) In imposing any conditions, the Authority must have regard to its duty under section 41.
- (3) If the Authority proposes to impose conditions on a person it must give him a warning notice.
- (4) If the Authority decides to impose conditions on a person it must give him a decision notice.
- (5) A person who is subject to a condition imposed under this section may apply to the Authority-
 - (a) for the condition to be varied; or
 - (b) for the condition to be cancelled.
- (6) The Authority may, on its own initiative, cancel a condition imposed under this section.
- (7) If the Authority has given its approval to a person subject to a condition, he may refer to the Tribunal-
 - (a) the imposition of the condition; or
 - (b) the Authority's decision to refuse an application made by him under subsection (5).

186. - (1) On considering a notice of control, the Authority may give a decision notice under this section to the person acquiring the control in question ("the acquirer") unless it is satisfied that the approval requirements are met.

- (2) The approval requirements are that-
 - (a) the acquirer is a fit and proper person to have the control over the authorised person that he has or would have if he acquired the control in question; and
 - (b) the interests of consumers would not be threatened by the acquirer's control or by his acquiring that control.
- (3) In deciding whether the approval requirements are met, the Authority must have regard, in relation to the control that the person-
 - (a) has over the authorised person concerned ("A"), or
 - (b) will have over A if the proposal to which the notice of control relates is carried into effect,to its duty under section 41 in relation to each regulated activity carried on by A.
- (4) If the Authority gives a notice under this section but considers that the approval requirements would be met if the person to whom a notice is given were to take, or refrain from taking, a particular step, the notice must identify that step.
- (5) A person to whom a notice under this section is given may refer the matter to the Tribunal.
- (6) "Consumers" means persons who are consumers for the purposes of section 138.

187. - (1) If the Authority is not satisfied that the approval requirements are met, it may give a decision notice under this section to a person if he has failed to comply with a duty to notify imposed by section 178.

(2) The Authority may (instead of giving a notice under subsection (1)) approve the acquisition of the control in question by the person concerned as if he had given it a notice of control.

(3) The Authority may also give a decision notice under this section to a person who is a controller of a UK authorised person if the Authority becomes aware of matters as a result of which it is satisfied that-

- (a) the approval requirements are not met with respect to the controller; or
- (b) a condition imposed under section 185 required that person to do (or refrain from doing) a particular thing and the condition has been breached as a result of his failing to do (or doing) that thing.

(4) A person to whom a notice under this section is given may refer the matter to the Tribunal.

(5) "Approval requirements" has the same meaning as in section 186.

188. - (1) If the Authority proposes to give a notice of objection to a person under section 187, it must give him a warning notice.

(2) Before doing so, the Authority must comply with such requirements as to consultation with competent authorities outside the United Kingdom as may be prescribed.

(3) If the Authority decides to give a warning notice under this section, it must do so before the end of the period of three months beginning-

- (a) in the case of a notice to be given under section 187(1), with the date on which it became aware of the failure to comply with the duty in question;
- (b) in the case of a notice to be given under section 187(3), with the date on which it became aware of the matters in question.

(4) The Authority may require the person concerned to provide such additional information or documents as it considers reasonable.

(5) Different requirements may be imposed in different circumstances.

(6) In this Part "notice of objection" means a notice under section 186 or 187.

Improperly acquired shares

189. - (1) The powers conferred by this section are exercisable if a person has acquired, or has continued to hold, any shares in contravention of-

- (a) a notice of objection; or
- (b) a condition imposed on the Authority's approval.

(2) The Authority may by notice in writing served on the person concerned ("a restriction notice") direct that any such shares which are specified in the notice are, until further notice, subject to one or more of the following restrictions-

- (a) a transfer of (or agreement to transfer) those shares, or in the case of unissued shares any transfer of (or agreement to transfer) the right to be issued with them, is void;
- (b) no voting rights are to be exercisable in respect of the shares;
- (c) no further shares are to be issued in right of them or in pursuance of any offer made to their holder;
- (d) except in a liquidation, no payment is to be made of any sums due from the body corporate on the shares, whether in respect of capital or otherwise.

(3) The court may, on the application of the Authority, order the sale of any shares to which this section applies and, if they are for the time being subject to any restriction under subsection (2), that they are to cease to be subject to that restriction.

(4) No order may be made under subsection (3)-

- (a) until the end of the period within which a reference may be made to the Tribunal in respect of the notice of objection; and

(b) if a reference is made, until the matter has been determined or the reference withdrawn.

(5) If an order has been made under subsection (3), the court may, on the application of the Authority, make such further order relating to the sale or transfer of the shares as it thinks fit.

(6) If shares are sold in pursuance of an order under this section, the proceeds of sale, less the costs of the sale, must be paid into court for the benefit of the persons beneficially interested in them; and any such person may apply to the court for the whole or part of the proceeds to be paid to him.

(7) This section applies-

(a) in the case of an acquirer falling within section 178(1), to all the shares-

(i) in the authorised person which the acquirer has acquired;

(ii) which are held by him; and

(iii) which were not so held immediately before he became a person with control over the authorised person;

(b) in the case of an acquirer falling within section 178(2), to all the shares held by him at the time when he first became aware that he had acquired control over the authorised person; and

(c) to all the shares in an undertaking ("C")-

(i) which are held by the acquirer, and

(ii) which were not so held before he became a person with control in relation to the authorised person,

where C is the undertaking in which shares were acquired by the acquirer and, as a result, he became a person with control in relation to that authorised person.

(8) A copy of the restriction notice must be served on the authorised person to whose shares it relates.

(9) The jurisdiction conferred by this section may be exercised by the High Court and the Court of Session.

Reducing control: procedure

190. - (1) If a controller of a UK authorised person proposes to-

(a) cease to have control over the authorised person, or

(b) reduce control over that person,

he must first notify the Authority of his proposal.

(2) A controller of a UK authorised person who, in circumstances where he is not required to give notice under subsection (1), ceases to have that control or reduces that control must notify the Authority before the end of the period of 14 days beginning with the day on which he first becomes aware that-

(a) he has ceased to have the control in question; or

(b) he has reduced that control.

[3.]

(4) A notice under this section must-

(a) be given to the Authority in writing; and

(b) include details of the extent of the control (if any) which the person concerned will retain (or still retains) over the authorised person concerned.

Offences

191. - (1) A person who fails to comply with the duty to notify the Authority imposed on him by section 178(1) or 190(1) is guilty of an offence.

(2) A person who fails to comply with the duty to notify the Authority imposed on him by section 178(2) or 190(2) is guilty of an offence.

(3) Subject to subsection (3A), if a person who has given a notice of control to the Authority carries out the proposal to which the notice relates, he is guilty of an offence if-

- (a) the period of three months beginning with the date on which the Authority received the notice is still running; and
 - (b) the Authority has not responded to the notice by either giving its approval or giving him a warning notice under section 183(3) or 185(3).
- (3A) A person does not commit an offence under subsection (3) if as a result of carrying out the proposal to which the notice relates, the person holds less than 33% of the shares or voting power in—
- (a) the UK authorised person to which the notice relates; or
 - (b) a parent undertaking of the UK authorised person.
- (4) A person to whom the Authority has given a warning notice under section 183(3) is guilty of an offence if he carries out the proposal to which the notice relates before the Authority has decided whether to give him a notice of objection.
- (5) A person to whom a notice of objection has been given is guilty of an offence if he acquires the control to which the notice applies at a time when the notice is still in force.
- (6) A person guilty of an offence under subsection (1), (2), (3) or (4) is liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (7) A person guilty of an offence under subsection (5) is liable-
- (a) on summary conviction, to a fine not exceeding the statutory maximum; and
 - (b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.
- (8) A person guilty of an offence under subsection (5) is also liable on summary conviction to a fine not exceeding one tenth of the statutory maximum for each day on which the offence has continued.
- (9) It is a defence for a person charged with an offence under subsection (1) to show that he had, at the time of the alleged offence, no knowledge of the act or circumstances by virtue of which the duty to notify the Authority arose.
- [10. ...]
- [11. ...]

Miscellaneous

192. The Treasury may by order-

- (a) provide for exemptions from the obligations to notify imposed by sections 178 and 190;
- (b) amend section 179 by varying the circumstances in which is treated as having control over a UK authorised person;
- (c) amend section 180 by varying, or removing, any of the cases in which a person is treated as increasing control over a UK authorised person or by adding a case;
- (d) amend section 181 by varying, or removing, any of the cases in which a person is treated as reducing his control over a UK authorised person or by adding a case;
- (e) amend section 422 by varying, or removing, any of the cases in which a person is treated as being a controller of a person or by adding a case.

422. - (1) In this Act "controller", in relation to an undertaking ("A"), means a person (other than a custodian) who falls within any of the cases in subsection (2).

(2) The cases are where the person-

- (a) holds 10% or more of the shares in A;
- (b) is able to exercise significant influence over the management of A by virtue of his shareholding in A;
- (c) holds 10% or more of the shares in a parent undertaking ("P") of A;
- (d) is able to exercise significant influence over the management of A by virtue of his shareholding in P;
- (e) holds 10% or more of the voting power in A;

- (f) is able to exercise significant influence over the management of A by virtue of his voting power in A;
 - (g) holds 10% or more of the voting power in P; or
 - (h) is able to exercise significant influence over the management of A by virtue of his voting power in P;
- (3) For the purposes of subsection (2), shares acquired for the sole purposes of clearing and settling within a short settlement cycle are to be disregarded.
- (4) “Custodian” means a person who—
- (a) holds shares in a custodian capacity, and
 - (b) can only exercise the voting power attached to such shares under instructions given in writing or by electronic means.
- (5). ...]
- (6) "Shares"-
- (a) in relation to an undertaking with a share capital, means allotted shares;
 - (b) in relation to an undertaking with capital but no share capital, means rights to share in the capital of the undertaking;
 - (c) in relation to an undertaking without capital, means interests-
 - (i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking; or
 - (ii) giving rise to an obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.
- (7) “Voting power”—
- (a) includes, in relation to a person (“H”)—
 - (i) voting power held by a third party with whom H has concluded an agreement, which obliges H and the third party to adopt, by concerted exercise of the voting power they hold, a lasting common policy towards the management of the undertaking in question;
 - (ii) voting power held by a third party under an agreement concluded with H providing for the temporary transfer for consideration of the voting power in question;
 - (iii) voting power attaching to shares which are lodged as collateral with H, provided that H controls the voting power and declares his intention of exercising it;
 - (iv) voting power attaching to shares in which H has the life interest;
 - (v) voting power which is held, or may be exercised within the meaning of sub-paragraphs (i) to (iv), by an undertaking controlled by H;
 - (vi) voting power attaching to shares deposited with H which H can exercise at his discretion in the absence of specific instructions from the shareholders;
 - (vii) voting power held by a third party in his own name on behalf of H; and
 - (viii) voting power which H may exercise as a proxy where H can exercise the voting power at his discretion in the absence of specific instructions from the shareholders; and
 - (b) in relation to an undertaking which does not have general meetings at which matters are decided by the exercise of voting rights, means the right under the constitution of the undertaking to direct the overall policy of the undertaking or alter the terms of its constitution.

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