Skadden | Fintech Focus

September 9, 2024

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

Sebastian J. Barling
Partner / London
44.20.7519.7195
sebastian.barling@skadden.com

Simon Toms
Partner / London
44.20.7519.7085
simon.toms@skadden.com

Joseph A. Kamyar
European Counsel / London
44.20.7519.7325
joseph.kamyar@skadden.com

David Y. Wang
Associate / London
44.20.7519.7149
david.y.wang@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

22 Bishopsgate
London EC2N 4BQ
44.20.7519.7000

Investing in Fintechs — Navigating the UK Regulatory Approval Process

As the UK Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) consider feedback to their consultation on guidance regarding the UK change-in-controller regime (consultation paper 25/23), we provide a refresher on how the current rules apply to fintech investors, changes on the horizon and what that may mean for fintech investment terms.

The Current Change-in-Control Regime

Any proposed acquisition of "control" over a regulated entity in the UK will require approval by the FCA or PRA (as applicable) of the new "controller." The controller must notify authorities of the proposed acquisition as soon as a decision to acquire has been made, and regulatory approvals must be obtained prior to a transaction's closing. The process gives the regulators the opportunity to assess or challenge a new direct or indirect controller of an FCA- or PRA-regulated firm. This is known as the "change-in-control" regime.

FCA or PRA?

The FCA is the relevant regulator for change-in-control purposes of FCA solo-regulated firms such as consumer credit firms, insurance intermediaries, investment firms, payment institutions/e-money institutions, financial advisors, mortgage brokers and claims management companies.

The PRA is the relevant regulator for change-in-control purposes in PRA and FCA dual-regulated firms, such as licensed banks.

Control Thresholds

In general, the thresholds for "control" notifications under the Financial Services and Markets Act 2000 (FSMA) are set at 10%, 20%, 30% and 50% of the voting rights **or** capital (subject to certain exceptions).[1]

For entities with share capital, the calculation of the capital threshold is based on (x) a numerator equal to the total number of shares held by a party (including both preferred and common shares) and (y) a denominator equal to the total shares issued and outstanding.

[1] Exceptions apply to certain types of firms. For "non-Directive firms" including non-MiFID investment firms, insurance intermediaries, full-scope consumer credit firms, home finance providers and full-scope alternative investment fund managers (AIFMs), the threshold is 20%. For FCA-registered cryptoasset firms, the threshold is 25%. For limited consumer credit firms, the threshold is 33%.

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

An entity will also be a "controller" if it holds capital or voting power below these thresholds but is otherwise able to exercise "significant influence" over a regulated entity, or a parent of such an entity, as a result of the shareholding or voting power obtained. See also our section below regarding updates to the change-in-control process and the "significant influence" test.

Notification and Approval Process

Upon notification by the proposed incoming controller, the relevant regulator has 60 **working days** to assess the proposed acquisition. This period, known as the "assessment period," allows the regulator to evaluate whether the acquirer meets the necessary standards for suitability and whether the acquisition could impact the firm's compliance with regulatory obligations. The regulators are empowered to "stop the clock" by 20 working days if they require additional information in the context of control changes in regulated firms. Should the assessment period end without a response and the regulators have both deemed the application complete and not exercised their right to request further information, the notification will be deemed to be accepted.

The regulators will assess all potential controllers, including the reputation and competency of the acquirer and indirect acquirers (including their management and boards). Those acquiring over 50% in a regulated firm are subject to further scrutiny; the regulators will assess the likely impact of the transaction on the regulated firm, intentions to make changes to the regulated firm (which will need to set out intended changes to governance, integration planning and target markets), transaction rationale and proof of funding.

The FSMA empowers the PRA or FCA to grant a "conditional approval" imposing specific conditions or undertakings on the controller as a condition of approving the transaction. These conditions are designed to ensure that the proposed acquisition will not adversely affect the underlying regulated firm's compliance with the regulatory system, financial stability or ability to operate in a sound and prudent manner. While the imposition of conditions is a tool available to the regulators, its use is relatively rare, as most issues are resolved during the preapproval discussions and information-gathering phases. However, when conditions are imposed, they typically require the acquirer to address specific regulatory concerns regarding the regulated firm, such as enhancing governance frameworks or maintaining sufficient capital levels.

In addition to the obligations above, a target FCA- or PRA-regulated firm must also notify its relevant regulator of any potential acquisitions of control. This notification may be filed separately or jointly with the notification of the proposed controllers.

Once approved, a controller has three months to complete the acquisition or close the transaction. This period may be extended by three-month increments with prior approval of the regulators.

Current Processing Times

According to the FCA's Q1 2024/25 operating service metrics, once all necessary application information was deemed to be complete, the FCA processed change-in-control applications within the statutory 60 working days in 100% of cases, with an average decision time showing consistent efficiency in managing these notifications. The medium determination time was 33 days, lower quartile determination time was 13 days, and upper quartile timing was 62 days. The processing times reflect the enhancements the FCA has made to its change-in-control team, whereas the different quartiles reflect a distribution of outcomes for simple versus complicated change-in-control notifications.

Updates to the Change-in-Control Process

As flagged in our last December 2023 update, UK regulators have proposed specific rules and guidance to reflect the post-Brexit regulatory landscape. These changes introduce significant updates and clarifications particularly affecting private equity (PE) funds, hedge funds, sovereign wealth funds, investment firms and cryptoasset businesses. As a result, fintech investors can expect scrutiny of their prior investments in the financial services sector, their investment rationale and exit strategies, governance and decision-making frameworks, and their approach to anti-money laundering efforts. Sovereign wealth funds may also be required to detail the government department defining the fund's investment policy (among other things).

The FCA has indicated that certain transactions may benefit from a lighter-touch approach, specifically sub-20% stake investments and approvals for controllers already known to the FCA. The implication is that fundraisings with established and active investors in the space may benefit from a smoother path to approval, in comparison to buyouts or more material investments with new entrants in the sector.

The new regime will be implemented through a PRA supervisory statement and FCA guidance, which largely replicate but simplify and update the existing EU guidelines, with new powers introduced by the Financial Services and Markets Act 2023.

The revised guidance also clarifies when an obligation to notify regulators arises during a change in control, including in relation to limited partners in fund structures, potentially expanding the scope of who needs preapproval. The updates further develop the concept of "significant influence" and include UK-specific

examples — such as the ability to direct or influence decisions of a board (despite not being on the board), making recommendations to the board that are always followed and veto powers — that could indicate control and therefore require closer scrutiny and early regulatory engagement.

Separately, pursuant to recommendations made by the Financial Action Task Force, the FCA is proposing to require controllers and beneficial owners of firms to obtain criminal background checks (undertaken within the prior six months) from the Disclosure and Barring Service (or the equivalent authority for those outside of England and Wales) as part of a change-in-control notification. Investors should factor this into their approval time lines, particularly where non-UK jurisdictions are involved (albeit the FCA notes that there may be exceptional cases where an equivalent cannot be obtained due to jurisdictional limitations). This requirement will apply to all new notifications submitted from January 2025 onward and will not impact any notifications made prior to this date (including those in progress).

Note that intragroup reorganisations remain subject to change-in-control approval regarding any new controllers pursuant to such reorganisations, subject to a simplified process.

What Does This Mean for Fintech Investments?

Know Your Counterparty

Fintech firms and their shareholders will continue to scrutinize the quality of investors when considering potential entrants to their cap tables, and particularly acquirers in the case of an exit. This approach is apparent in competitive auctions, where sellers continue to cite deal certainty as a critical factor in their assessment of bids. Consequently, we can expect renewed focus on the due diligence undertaken on investors, as sellers and targets seek to secure a smooth path to closing. In addition, established fintech investors with a proven track record of successful investments will continue to leverage their status, especially now that regulators have signaled that veteran investors may benefit from a lighter-touch review.

How Big a Cheque?

The regulators' clear distinction between sub and plus 20% investments may incentivize fintech firms to seek a broader investor base for future fundraisings in order to reach a timely closing. Anchor investments, particularly from new entrants in the fintech space, may have less appeal, and PE investors will also need to consider the disclosures related to their limited partners that may be expected for any proposed material investments. Structuring transactions around regulatory approval requirements will likely continue, with fintech firms staggering closings in a given funding round to enable investments (*e.g.*, sub-10% or 20%) to close first, facilitating immediate or quicker access to cash for the business.

Hell or High Water

With further clarity of the UK change-of-control regime will come increasing demands on investors to commit to a "hell or high water" standard in relation to regulatory conditions precedent. This typically comprises a broad investor-side commitment to take action, however onerous, to secure the required regulatory approval, including complying with any undertakings or conditions demanded by the relevant regulator. Asking investors to accept this level of regulatory risk can be a challenge, particularly where antitrust conditions are at play, though we are seeing investors accept greater levels of regulatory risk where limited to financial regulatory approvals. Alternatively, reverse break-fees can be a more palatable mechanism for addressing regulatory concerns.

Governance

The changes to the "significant influence" test mean that regulators will consider board composition, the ability of investors to influence board decisions, provisions of articles of association and shareholder agreements, and the existence of veto rights in determining whether there has been a change in control.

The principle is not new; however, the revised guidance will cause investors and fintech firms to take a second look at the scope of governance rights afforded to shareholders, particularly in minority transactions that are not intended to trigger change-in-control thresholds. The rights will need to be considered holistically, but could curb minority investors' demands for onerous control rights, whether through a broad scope of reserved matters under a shareholders' agreement, veto/consent rights within the articles, weighted voting, control of board committees or casting votes at the board level.

What's Next?

The proposed changes to the guidance on the UK change-in-control regime significantly clarify the regulatory expectations for certain types of investors. The consultation closed on 24 February 2024, and we can expect authorities to announce and implement the final regime by the end of the year.