ICAEW
REPRESENTATION 81/21

NATIONAL SECURITY AND INVESTMENT ACT 2021

Issued 31 August 2021

ICAEW welcomes the opportunity to comment on the consultation on *National Security and Investment Act 2021: Draft statement for the purposes of section 3*, published by BEIS on 20 July 2021, a copy of which is available from this link

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This ICAEW response of 31 August 2021 has been prepared by the Corporate Finance Faculty. Recognised internationally as a source of expertise on corporate finance issues and for its monthly *Corporate Financier* magazine, the faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, law firms, consultants, academics and brokers

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GENERAL POINTS

The policy statement

1. The National Security and Investment Act 2021 (NSI Act) requires the statement to be reviewed at least every five years, and we strongly recommend that the first review be carried out earlier rather than later in that term. The new regime is a step change for businesses, investors and advisers and there will be a steep learning curve.
2. The Draft statement for the purposes of section 3 (the Statement) provides some, though not complete, clarity as to how the call-in power will be used. We have included examples in our answers below, as well as suggestions aimed at improving business' ability to decide whether an acquisition is likely to be called in.
3. Absent any guidance from the Government as to what amounts to a security risk, there will remain scope for interpretation by businesses, investors and advisers. Parties will only be able to improve their understanding the approach after January 2022. From the outset, and while the regime is bedded in, the ISU must be prepared for and resourced to manage, and turn around, many precautionary notifications. To promote certainty, the Government could consider publishing the rationale for decisions that are less sensitive, such as decisions not to intervene.

Role of the expert panel

4. ICAEW's members are involved in running, advising and investing in businesses in the UK (and overseas), and have a strong interest in the efficient operation of the new regime under the NSI Act. ICAEW continues to be engaged, including in an industry expert panel, to support the Government as it establishes the infrastructure for operating the regime. The government should maintain and continue to consult the expert panel as the new regime settles in, and ICAEW is very willing to continue its contribution.

ANSWERS TO SPECIFIC QUESTIONS

Q1. Is the statement clear in its description of how the Secretary of State expects to use the call-in power provided by the NSI Act?

5. The Statement is clearer than the earlier version (Draft Statement of Policy Intent, published in June 2018), however, over-notification remains likely. We set out below some ways for making the Statement more informative.
6. The Statement does not indicate how the Government the impact of multiple reviews an entity (and transaction) may be subject to because of the entity's obligations to other regulators, eg, the FCA, or utility regulators. The Government is best placed to provide guidance that will help businesses prepare for discharging all their obligations.
7. The only insolvency exemption in the NSI Act applies to the appointment of receivers - there is no explicit reference in the Statement to the appointment of other insolvency officeholders or fixed charge receivers. Would the Government state whether or not it expects to use the call-in power on such appointments and, if so, the risk factors or considerations that will be taken into account? See also our point in para 11 below.
8. Examples of conditions or remedies that the Government may impose on a transaction which has been determined to create a national security risk, should be included in the Statement. This would provide parties to transactions with a tangible understanding of the potential impact.
9. We suggest that drafting could be improved in para 5 of the Statement as follows:

   '*This applies to all qualifying acquisitions, whether they involve parties* <u>*or assets*</u> ~~*only*~~ *within the UK or* ~~*also involve parties*~~ *overseas,* <u>*or both*</u>.'

   The words '*only'* and 'also' suggest that there needs to be at least one UK party in order for the NSIA to be engaged. But it is clear from the definition of 'qualifying entity' in the Act that

there need not be any UK entity involved, provided that there is a sufficient commercial link to the UK.

Q2. Does the statement help you to decide whether your acquisition is likely to be called in?

10. The Statement includes some additional details on notifiable transactions and the examples provided are useful. However, ambiguities remain, such as the following:
    - Why is Computer Hardware listed in the 17 areas of the economy, whereas computer software is not?
    - The reference (in para 11 of the Statement) to areas which are *'closely linked'* to the 17 mandatory sectors is not clear about what this means in practice. For example, which entities and assets will be considered to be *'closely linked'* to the energy sector? This could refer to a very wide range of entities and assets. It is understood that the call-in power will not apply *exclusively* to the 17 mandatory sectors: if this were the case, the NSIA would only need the mandatory notification regime, and the general call-in power would be redundant. But, for the sake of certainty, a higher standard than '*closely linked*' would be preferable. For example, the Statement could refer to areas of the economy which are 'fundamental to the operation of' the 17 mandatory sectors, or 'inextricably linked with' the 17 mandatory sectors.
    - The earlier version stated that transactions in the *'Wider Economy'* are only expected to be called in *'on an exceptional basis*'. The Statement (para 12) states that acquisitions outside the 17 mandatory sectors are '*unlikely to be called in*' and, in relation to Asset acquisitions (in para 32), the terminology used is '*rarely*'. The drafting is not as helpful for parties and their advisers as '*exceptional basis*', as the latter invites a consideration of whether there are exceptional circumstances which might make it advisable to submit a filing. The word '*unlikely'* merely implies a continuum of likelihood, which is more difficult for parties to assess.
    - In the earlier version, loans and conditional acquisitions were included as events with potential call-in risk, however these do not feature in the Statement. Does this mean that the Government's position has changed on the risk relating to banking and finance transactions? If so, it would be useful if this could be explained, and if not, it would be helpful for the final Statement to be explicit about these transactions.
11. The Government's intentions regarding the actions of a receiver or liquidator are not referred to in the statement (see also para 7 above). Such a party may direct the control of an entity or asset through the exercise of express contractual, statutory and/or common law powers/ duties, rather than through the acquisition of a shareholding. Are there circumstances where the Government would interpret such a situation as an acquisition of 'material influence' over the underlying entity?
12. The five year-period for retrospective call-in means that voluntary notification may be the only way for a business to partly mitigate the impact of such a lengthy period of uncertainty on transaction pricing and risk allocation. The burden to businesses of such notifications will, of course, be mirrored in demands on the ISU.
13. In the consultation paper (page 8) the Government states it will publish guidance that covers an overview of the NSI Act and specific topics, including extraterritorial application and how the Act works alongside other regulations and market practices as well as sector guidance. Businesses, acquirers and other users of the statement will be greatly assisted if links to such guidance are included at appropriate sections in the published version.

Q3. Are the risk factors that the Secretary of State will consider set out in an understandable way?

14. Our principal comments on the risk factors relate to three themes. The first is the absence of risk factors in insolvent situations and enforcement of security by a lender which, as explained in para 10 above, does not help lenders to decide whether an action may be called in.
15. The second concerns the clarification (in para 15 of the Statement) that that any one of the risk factors alone could result in a call-in. This is particularly useful when read alongside

'*when the target or acquirer risk is low, the Secretary of State is less likely to be concerned about the amount of control acquired*' (para 26 of the Statement). It would be useful to understand how the grading of the three risk factors will interact, whether certain risk factors will be given a higher weighting than others, and how this may differ between acquisition of assets and entities. For example, it is clear from Example 2 that the call-in decision is not based purely on an acquisition where any one or two of the risk factors is graded higher than '*low'*.

16. The third area of comment relates to the explanation of 'Acquirer risk' (page 4 of the Statement). Here, characteristics of the acquirer that the Government is likely to consider, to understand the level of potential risk the acquirer may pose, include aspects that may seek to undermine or threaten '*the UK's reputation'*. The Government should give guidance on what could undermine or threaten reputation.

17. In the Statement, 'Acquirer risk' may be assessed by reference to sensitive information which will not be available outside Government. For example, Example 1 refers to '*The UK Government [having] concerns that the activities of Party B may be linked to hostile activity*'. And Example 5 says that '*Party G is known by the Government to have existing ties to an organisation that is hostile to the UK*'. Presumably, in both these cases the Government's knowledge of Party B's links and Party G's ties would not be public, and therefore would not be known to their M&A counterparties or advisers. This means it would be challenging or impossible for these parties to assess 'Acquirer risk'. Would the Government consider providing further guidance on the types of acquirers which are more likely to cause concern?

18. For example, guidance that would help parties to assess 'Acquirer risk' would answer questions such as the following:

    - Would the entity which is the subject of sanctions be more likely to be high-risk?
    - Would an entity or individual from a state which is sanctioned be more likely to cause concern?
    - Would links to an overseas 'Politically Exposed Person' in such a state be a relevant factor?
    - Would previous criminal convictions of particular types (eg trafficking offences, or hacking offences) be relevant?

19. We suggest that drafting could be improved in para 20 of the Statement, by referring to 'areas of the economy closely linked to those qualifying entities', not '*areas of the economy closely linked to those acquisitions'*.

20. In para 21 of the Statement, it may be helpful to refer to *'links to entities or states which may seek to undermine or threaten the interests of the UK*'. It is clear from para 27 that '*allegiance to a state…which is hostile to the UK*' may be relevant, so presumably an entity's links to a hostile state may be relevant too.