

How Gov't Response Addresses Investment Act Concerns

By **Solange Leandro, Sarah Tighe and Lauren Buchan** (May 24, 2024)

The government's response to a November 2023 call for evidence[1] was published on April 18.[2] The call for evidence allowed stakeholders to share views on the operation to date of the U.K.'s National Security and Investment Act 2021, or NSIA, now in force for more than two years.

Engagement levels to the call for evidence were encouraging, and the feedback provided a useful insight, due to the direct involvement in the screening system by over 75% of the respondents.

This article will discuss the next steps and the five areas on which the government will focus between now and the autumn. Broadly, the response is positive, and the five areas are largely an appropriate response to stakeholder concerns.

An updated Section 3 statement — setting out how the secretary of state will exercise the power to issue a call-in notice — updated market guidance, plus potential revision of the definitions in the 17 mandatory sectors, should together prove the most practically useful for stakeholders and their lawyers.

The NSIA is broad and far-reaching. However, the government has made clear that its intention is not to interfere arbitrarily with investment, which is reflected in the fact that in the financial year 2022-2023, 93% of notifications were cleared without being called in.

The government called in 65 acquisitions for further assessment, ultimately intervening in just 15 deals.[3]

A key part of the regime is to give investors into the U.K. sufficient certainty to do business, while protecting the U.K.'s national security. The feedback to the call for evidence is that we have not yet reached the level of certainty required by investors.

Five Areas of Focus

1. Updated Section 3 Statement — May 2024

The government provides clarity as to how and when it expects to exercise its power to issue a call-in notice through its Section 3 statement.[4]

The call-in power may be used if the secretary of state reasonably suspects the acquisition has given, or may give, rise to a risk to national security.

Stakeholders and their lawyers often use this statement during transactions to help assess the risk of a call-in. It can also inform decision making around the submission of voluntary notifications in order to remove any residual risk of a call-in.

Through the call for evidence, the government requested feedback as to how well stakeholders feel they understand the NSIA and the risks it is intended to address.



Solange Leandro



Sarah Tighe



Lauren Buchan

While "80% of all respondents agreed or strongly agreed they have a good understanding of the risks the government is seeking to address," some requested further detail around the areas of the economy considered the most sensitive and how national security risk in respect of a transaction is assessed.

Accordingly, an updated Section 3 statement will be published by the end of this month, including the factors the government expects to consider when exercising its call-in power. This is welcome to inform the conditionality of completion.

The government further clarified that a suggested fast-track process for certain types of acquirers is not under consideration because transactions need to be assessed on a case-by-case basis.

This might be disappointing for stakeholders, especially in view of any NSIA filing being built in as a condition to completion in transaction documents.

However, the government commits to responding within 30 days of submission of a complete NSIA filing, which does give stakeholders some certainty when drafting those conditions and preparing for completion.

2. Updated Market Guidance – May 2024

The government publishes and maintains detailed guidance for stakeholders that is designed to assist them as they navigate the NSIA.

However, the government is receptive to the need for further guidance in specific areas and the response notes the following feedback:

- 81% of respondents requested further specific guidance across a range of areas, including the factors the government expects to take into account when assessing risk, how the NSIA applies to transactions in academia and how statutory time limits are calculated;
- Over 30% of respondents requested further guidance on what is captured by the mandatory area definitions; and
- 38% of all respondents said they would welcome further specific guidance on the situations in which the NSIA can apply to outward direct investment.[5]

Accordingly, the government has stated its intention to publish further market guidance on the topics stakeholders have raised by the end of this month.

The government's existing market guidance has been useful when handling the less clear-cut or more practical questions of NSIA application.[6]

The further, clearer guidance suggested, with more practical examples, is welcome and should stay regularly updated, as previously, to reflect stakeholder concerns and changing security issues.

The government has further indicated that it does not intend to exempt transfers of control in respect of automatic enforcement provisions in secured lending agreements, i.e., where voting rights are automatically transferred, based on the responses given.

This ties in with its case-by-case assessment of transactions caught by the NSIA. However, our view is that the government's existing position on these provisions is clear and that it is also considering updating its guidance, which should give stakeholders further comfort.[7]

3. Consultation on 17 Sensitive Sectors – Summer 2024

The government has sought to assess whether stakeholders understand which activities might bring an entity into the 17 sensitive sectors. Also, whether there are areas of the economy currently captured by the regulations, but that are unlikely to pose a risk to national security or place a heavy burden on business and investment.

The government also considered expanding existing areas of the regulations and creating new categories of notifiable activities in new sectors, including:

1. Clarification of the scope of the advanced materials, critical suppliers to government and synthetic biology sectors;
2. Clarification and expansion of the data infrastructure and suppliers to the emergency services sectors;
3. Refining the scope of the artificial intelligence sector and refining and clarifying the defense sector;
4. Expansion of the scope of the communications sector;
5. Updating the energy sector, which is rapidly developing in view of the U.K.'s 2050 net-zero goal; and
6. Grouping certain activities under new sectors of the economy — being semiconductors and critical minerals.

In the response, of the 63% of respondents that provided feedback on the proposed changes to the definitions, over half indicated that they understood the activities that might bring an entity in scope of the NSIA's mandatory notification regime.

However, respondents requested clear definitions or guidance in the sectors identified in 1-5, above. Artificial intelligence, advanced materials, defense and critical suppliers were identified in particular by respondents.

The government will, by the summer, launch a formal consultation in relation to the definitions of the 17 sensitive sectors of the economy. The consultation will include the proposal for separate semiconductor and critical minerals sectors and may also include water.[8]

We therefore have short-term and long-term solutions proposed by the government: First, issuance of market guidance imminently that should provide clarity on the existing definitions, followed by a future, stronger proposal to amend those definitions.

The amendments could affect whether the activities of a target entity fall within the mandatory regime of the NSIA.

4. Technical Exemptions – Autumn 2024, Subject to Parliamentary Time

Scottish Law Share Security and Internal Reorganizations

The position in relation to Scottish law share security differs from that of English law equitable charges over shares, because, unlike an English equitable charge, Scottish law

share security involves transfer of title in the shares from the charger to the security agent.

Existing government guidance states that the creation of such share pledge in relation to an entity falling within the NSIA would require an NSIA notification.[9]

Similarly, the applicability of the NSIA to internal reorganizations, including those where ultimate beneficial ownership remains the same, has added an additional layer of complexity to restructurings that clients may reasonably assume fall outside of the NSIA.

Scottish law share security and certain internal reorganizations are now under active consideration for targeted exemptions from the mandatory notification regime, subject to the government's assessment on feasibility and the potential national security impact.

An exemption relating to internal reorganizations would be particularly welcome. Otherwise, clearer guidance on when an internal reorganization may be a cause for concern.

Liquidators, Receivers, etc.

The NSIA allows administrators or creditors of a company in certain insolvency proceedings to exercise rights without triggering the requirement to obtain clearance.[10]

However, liquidators and receivers do not currently benefit from the same carveout. This means that their appointment could trigger a mandatory notification if the other elements of the NSIA are engaged.[11]

The response notes that 25% of all respondents supported an exemption for the appointment of liquidators, official receivers and special administrators from the NSIA mandatory notification regime.

The government is proposing secondary legislation to exempt the appointment of liquidators, official receivers and special administrators.

The details will be crucial, but the development will be welcome for secured finance parties for whom time is of the essence when enforcing security — not least because administration is not always possible or realistic and administrators have the same type of control over distressed assets and entities.

5. Operation of NSI System

- Since the inception of the NSIA, improvements to the system have already been made. However, the government has welcomed suggestions for further improvement and in the response, is receptive to the following: 19% of all respondents called for greater transparency around the operation of the NSI system;
- Commentary on the Investment Security Unit's engagement with stakeholders following notification and the length of the assessment process;
- Opposition to requesting further information through notification forms; and
- The digital notification process generally works smoothly, but over half of the respondents provided feedback on improvements that could be made to the portal, including false positive firewall blocks.

Given a fast-track process is not yet on the cards and potential exemptions are limited at this stage, the length of the assessment process will be a key issue for stakeholders and lawyers.

Lawyers who also frequently submit NSIA notifications on a client's behalf will be pleased to note plans to improve the portal. Whether or not the calls for greater transparency can be met through the imminent guidance remains to be seen.

Conclusion and Key Takeaways

Key takeaways from the response are that we can expect:

- An updated Section 3 statement by the end of this month, through which we hope to better understand the factors the government will take into account when exercising its call-in power and key areas of risk under the NSIA;
- Updated market guidance by the end of this month; and
- A consultation in due course on revised definitions in the 17 existing sectors and potentially in new sectors.

The government is also considering a limited number of exemptions at this stage. We are encouraged by their recognition of some of the key concerns raised by stakeholders.

Our experience of the NSIA's evolution so far is that the government is willing to respond to live issues stakeholders are experiencing in relation to the NSIA, such as the issuance of English law share security and regularly updating market guidance.

We hope that such responsiveness continues and that the commitments in the response come to fruition. In this way, the application of the NSIA can be woven more seamlessly into transactions, and ultimately meet the government's aim of improving investor certainty, without compromising on the U.K.'s national security.

Solange Leandro is a partner, Sarah Tighe is knowledge counsel and Lauren Buchan is an associate at Watson Farley & Williams.

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[1] <https://www.gov.uk/government/calls-for-evidence/call-for-evidence-national-security-and-investment-act/call-for-evidence-national-security-and-investment-act>.

[2] <https://www.gov.uk/government/calls-for-evidence/call-for-evidence-national-security-and-investment-act/outcome/national-security-and-investment-act-2021-call-for-evidence-response#scale-of-responses>.

[3] See the Annual Report 2022-2023 for more information.

[4] <https://www.gov.uk/government/publications/national-security-and-investment-statement-about-exercise-of-the-call-in-power/national-security-and-investment-act-2021-statement-for-the-purposes-of-section-3>.

[5] The call for evidence notes that "In certain narrow and specific situations, the NSI Act can apply to Outward Direct Investment (ODI), including where that ODI involves asset transfers alongside the investment."

[6] Market guidance: <https://www.gov.uk/government/publications/national-security-and-investment-nsi-act-market-guidance-notes/national-security-and-investment-market-guidance-april-2023#changes-to-the-guidance-on-national-security-and-investment-act-notifiable-acquisitions-in-the-17-mandatory-areas><https://www.gov.uk/government/publications/national-security-and-investment-act-guidance-on-notifiable-acquisitions/national-security-and-investment-act-guidance-on-notifiable-acquisitions>.

[7] <https://www.wfw.com/articles/the-evolution-of-the-nsia>.

[8] 26% of respondents who answered this question expressed support for separating these areas.

[9] <https://www.gov.uk/guidance/national-security-and-investment-act-guidance-on-acquisitions#the-granting-of-security-over-shares>.

[10] Schedule 1, paragraph 6(2) NSIA.

[11] <https://www.gov.uk/guidance/national-security-and-investment-act-guidance-on-acquisitions#the-appointment-of-liquidators-or-other-insolvency-measures>.