

The top ten things lenders should know about the National Security and Investment Bill

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The UK government is establishing a stronger and wider-ranging regime for screening foreign investment. The proposals are set out in the National Security and Investment Bill, which is currently the subject of Parliamentary scrutiny, and which is expected to become law by the end of 2021. The Bill has retrospective effect, so it is important that lenders are aware of its implications now for loans and other financial instruments.

1. The Bill introduces a **mandatory notification regime** for notifiable acquisitions in **17 key sectors**. It will be unlawful to complete these transactions unless and until they are approved by the Secretary of State for Business, Energy and Industrial Strategy (BEIS). The specific sectors (which have yet to be finalised, but which were refined by the government and republished on 2 March 2021) are: civil nuclear; communications; data infrastructure; defence; energy; transport; artificial intelligence; advanced robotics; computing hardware; cryptographic authentication; advanced materials; quantum technologies; synthetic biology; critical suppliers to government; critical suppliers to the emergency services; military or dual-use technologies; and satellite and space technologies.
2. Other transactions, which the parties consider could give rise to a national security risk, may be notified to BEIS on a **voluntary** basis to obtain approval.
3. The Bill applies to non-UK purchasers, as well as UK domestic purchasers, of **qualifying entities** and assets. A qualifying entity includes a foreign entity if it carries on activities in, or supplies goods or services to, the UK. (See point 8 below for details of qualifying assets.)
4. The new regime will apply to direct or indirect acquisitions of:
 - certain shares, voting rights and material influence in a qualifying entity. Acquisitions as low as **15% or more of shares or voting rights** (and possibly lower in the case of material influence) can be subject to review; and
 - a right or interest in a qualifying asset, where this enables the acquirer to use the asset, or direct or control how the asset is used.
5. The Secretary of State may "**call in**" for review any transaction (whether or not notified), to assess and address any national security risk. A call-in notice may be issued up to **six months** after the Secretary of State becomes aware of the transaction, provided that is within **five years** of the transaction completing – but if the transaction is subject to mandatory notification and is not notified, **no time limit** will apply.
6. The Secretary of State will have power to "call in" transactions which take place from 12 November 2020, but will not "call in" transactions before the new regime has come into force. **This means that relevant transactions currently being negotiated (or agreed but not yet completed) will be subject to the new regime, once it is enacted.** If a transaction falls within one of the proposed 17 key sectors, or could otherwise give rise to a national security risk, the parties should consider seeking informal advice from BEIS now. It may be possible to obtain an informal comfort letter.
7. The Secretary of State can block, or impose conditions on, transactions to remedy any identified national security risk. There are **severe penalties** for completing a notifiable acquisition without approval and any such acquisitions would be legally void. The penalties include criminal charges with imprisonment for up to five years, and fines of up

to £10 million (or, if higher, 5% of worldwide turnover).

8. **Asset acquisitions** will not be subject to mandatory notification, but may be "called in". This includes acquisitions of control over land, tangible movable property (such as machinery used to make defence components), or ideas, information or techniques which have industrial, commercial or other economic value (such as designs, source code or software). Interventions for asset transactions are expected to be very rare, unless they are integral to an entity's relevant activities in a key sector, or the land is in a sensitive location (e.g. because it is close to a military base).
9. **Loans, conditional acquisitions, futures, and options** are not exempt from scrutiny, although the rights exercisable by an administrator or by creditors while an entity is in relevant insolvency proceedings are exempt.
10. The overwhelming majority of loans and other financial instruments are expected to pose no national security concerns, including those within the 17 key sectors. In the rare circumstances where they do pose concerns, the Secretary of State only expects to intervene when an actual acquisition of control takes place (e.g. a lender seizing collateral). More generally, lenders will need to consider the possible impact of the proposed new regime for loans used to fund acquisitions of businesses within any of the 17 key sectors, given that the transaction being funded may be at risk of being unwound (and especially if relying on security over the target business).

Example 1

Asset A is a site adjacent to a sensitive UK defence base. Borrower B takes out a loan from Lender C and gives Asset A as collateral. Borrower B defaults on the loan and Lender C enforces its security over Asset A. This may give rise to national security risks if the entity taking control of Asset A post-enforcement is (or is controlled by) a hostile actor, as the proximity of Asset A could allow the acquirer (or its controller) to gather sensitive information about the operations of the defence base.

Example 2

Lender D takes security over the shares in Company E. Following a credit default, Lender D wishes to use that share security to exercise control over Company E. This may give rise to national security risks depending on the UK activities of Company E and, in particular, whether Company E is active in any of the 17 key sectors.

Example 3

Lender F has security over the shares in company G, which is active in one of the 17 key sectors. It is not uncommon for share security to include rights to direct voting rights on the shares (usually post-default). A right to direct voting could trigger the mandatory notification regime, so Lender F needs to obtain any relevant approval in advance.

It is therefore important for lenders to be aware that enforcing security over shares, land or other assets could be subject to notification and/or review, as could a subsequent sale by the security holder of the shares or asset over which security was taken. This could apply when enforcing existing security rights granted well before the new regime comes into force (or was even proposed). Whilst decisions regarding enforcement are typically taken following thorough review/legal advice, the potential for delays due to notification/"call-ins" could be particularly acute where the ability to enforce quickly and decisively is essential to the transaction (e.g. margin lending).

For further information, please contact one of our team.

Your Key Contacts



Adrian Magnus

Partner, London

D +44 20 7320 6547

M +44 7768 523225

adrian.magnus@dentons.com



Christopher Graf

Partner, London

D +44 20 7246 7206

M +44 7824 320864

christopher.graf@dentons.com



William Turner

Partner, London

D +44 20 7246 7449

M +44 7500 795594

william.turner@dentons.com



Rebecca Owen-Howes

Counsel, London

D +44 20 7246 7523

M +44 7733 307375

rebecca.owen-howes@dentons.com