



NATIONAL SECURITY AND INVESTMENT - A CONSULTATION ON PROPOSED LEGISLATIVE REFORMS

Issued 19 October 2018

ICAEW welcomes the opportunity to comment on the *National Security and Investment White Paper* published by Department of Business, Energy and Industrial Strategy on 24 July 2018, a copy of which is available from this [link](#).

A new national security and investment regime must apply appropriate safeguards and maintain an open approach to international investment. This delicate balance can largely be achieved through

- pre-empting and mitigating the inevitable uncertainty for the market, with a clearly defined policy scope and an open pre-consultation process;
- applying a proportionate and 'last resort' approach to scrutiny of, and intervention in, transactions; and
- a governance process of oversight to ensure consistency, fairness and accountability of the Senior Minister's decisions and of any remedies imposed.

This response of 19 October 2018 has been prepared by the ICAEW Corporate Finance Faculty. The Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. It is recognised internationally as a source of expertise on corporate finance and for its monthly Corporate Financier magazine. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, brokers, law firms, consultants, and academics.

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KEY POINTS

1. Foreign investment is crucial to UK businesses and the economy. Achieving workable legislation to protect against national security risks posed by such investment, but in a way that does not deter it, is a geopolitical and macroeconomic challenge facing the UK and many other countries.
2. ICAEW's members comprise business owners, advisers to business and investors, all of who may be affected by a new regime. We have consulted members across these groups on the clarity of scope and the workability of the proposed process. Furthermore, in October 2018, ICAEW hosted a roundtable on the proposed national security and investment regime. Senior officials from the DBEIS heard key policy stakeholders (investors, businesses and advisers) comment on aspects of the regime and propose certain improvements. Feedback from the roundtable has been referenced in this response.
3. The balance required of the new regime will, in our view, largely be achieved through
 - pre-empting and mitigating the inevitable uncertainty for the market, with a clearly defined scope and an open pre-consultation process;
 - applying a proportionate and 'last resort' approach to government scrutiny of, and intervention in, transactions; and
 - a governance process of oversight to ensure consistency, fairness and accountability of the Senior Minister's decisions and of any remedies imposed.
4. ICAEW will help raise awareness of the new regime and its implications among its members, and the wider business and finance audience.

ANSWERS TO SPECIFIC QUESTIONS

Question 1. What are your views about the proposed tests for trigger events that could be called in for scrutiny if they met the call-in test?

5. The trigger events regime would enable government scrutiny of more circumstances than current legislation permits, where acquisitions of control or influence over assets or entities may raise national security risks. The White Paper explains that the reforms are a necessary response to the changed threat to national security, due to economic, geopolitical and technological developments. We believe that, to enhance public understanding of, and support for, the nature of these reforms, it will be necessary to provide illustrations of how the threat has materialised.
6. The trigger events are intended to replace turnover and share of supply tests and, due to the increase of circumstances that they include together with the non-exhaustive list of at-risk sectors, greatly increase the scope of transactions potentially subject to scrutiny. Inevitably this increases uncertainty, and the likelihood of unintended consequences (see our response to question 2). We have focused here on matters where improved drafting will make the definition of trigger events as tight as possible.
 - **Significant influence and control (SI/C).** A more appropriate test of control, including 'material influence, could be that in the Enterprise Act 2002 used in the competition regime and is a well-established test. As drafted, examples given in the draft policy statement illustrate difficulties with SI/C. For instance, in 5.28, with respect to foreign states having SI/C over an entity, states being able to exert control or significant influence over the operational or strategic decisions of businesses includes the right to appoint board members. This potentially is very broad ranging and could even cover non-regulated businesses in certain jurisdictions which nonetheless are at the behest of the foreign state to secure (and maintain) basic business or operational licences. It could also capture regulated and infrastructure businesses which are operating under

formal (foreign) state/ government grants and authorisations. In our view the reference to being able to exercise control 'in practice' is too broad.

- **Lenders and loans.** Paragraph 5.60 envisages an overwhelming majority of loans not giving rise to national security concerns, however the example provided describes a situation where a lender has contractual or non-contractually ability to 'step-in' or influence. This potentially impacts many types of loan arrangement and we wonder whether this is the policy intention. In particular, in the case of start-up innovative businesses, lenders are likely to require such conditions. There may be grounds for the government to consider excluding from scope certain types of transactions, such as certain loan or debt arrangements.
- **Primary business objective and Core Areas.** Absent the turnover and share of supply tests, has the government considered whether trigger events should be in scope in a business for which the Core Area activity is not the primary business function?
- **Institutional investors/co-investors.** Many businesses in core areas - infrastructure, advanced technologies and advanced engineering - have a large, international investor base and/or cornerstone investors such as Limited Partners and Sovereign Wealth Funds. We think that the government might consider whether certain investors, for example, ones with no special rights and less than x% aggregate interest, can be excluded from scope.

Question 2. What are your views about the proposed role of a statement of policy intent?

7. The statement of policy intent should explain the nature of the risk being addressed and set out well-defined principles for government intervention. In developing the policy, the government should take into account possible unintended circumstances. A range of these is included in paragraph 11.
8. In the absence of information on states and parties that could have hostile intent toward the UK, the policy statement itself will help steer the business and advisory communities to play their part in avoiding and/or mitigating risk. This can be supported with illustrations of how the risk may, or has, materialise(d) – case studies designed to provide examples of trends or, to the extent possible, situations that have caused a national security concern. A list of issues (a checklist) for businesses and their advisers to think about will be very useful. Businesses and investors will need to give real consideration at an early stage, potentially about ring-fencing assets or technologies which may fall within scope – in order not to impede exit strategy or mitigate risk with an exit strategy. Equally guidance will also be useful on how certain types of investors should be looking at their own profile and group eg, global private equity or investment firm with portfolio companies across globe, including in certain potential hostile states. Is it possible to assume that, if the transaction in the UK does not involve a portfolio company in a hostile state, the regime would not be relevant (assuming no other triggers relevant)? There is precedent for this approach - in its campaign about the risk of cyber security breaches, the government described actual breaches together with their implications and published considerations for companies and boards.
9. Transparency of the policy intent will help businesses develop strategies for financing growth on an informed basis. 'Deal risk is very important' was a quote from a roundtable participant and transparency will help in this respect. It will make investors more aware of possible issues over entry/exit and provide assurance that UK continues to be open to foreign investment. Clarity of scope will help increase transparency. The policy statement should also be specific and give more examples of what is not in scope (carve-outs) as well as on the subject and context of any safe harbours. We have mentioned examples for the government to consider in our response to question 1.
10. The policy statement should include details of sanctions. It should be clear with whom responsibility lies for complying if a business is called-in, and about the parties that could be subject to sanctions. The policy statement should also set out the role of judicial oversight of decisions that are appealed. This information is currently in the White Paper but not in the draft policy statement. However, accountability will also be desirable for all decisions taken by the Senior Minister, whether or not they are appealed. There are various reasons why a

business may choose not to appeal a decision, but ongoing oversight to ensure that decisions are rational will enhance acceptance of, and support for, the regime. See also our response to question 8.

11. Possible unintended consequences include:

- Undermining of government policy in other areas; for example, potential restriction on investment in advanced technologies and national infrastructure could conflict with the focus of the Four Grand Challenges in the Industrial Strategy (AI and the data economy, clean growth, the future of mobility, and the future of mobility).
- Investors that are prevented from supporting or investing in Core Areas, may also be deterred from doing so in sectors that are not in scope. 'There is a risk of a knock-on chilling effect for investment in other sectors' was a quote from a roundtable participant.
- 'Uncertainty as to exit will add to investment uncertainty and deter investment' was a quote from a roundtable participant. Investors that are, prima facie, bone fide may be deterred from investing by a regime that complicates their ability to liquidate their investment, or rules out exit options. Existing investors may be deterred from providing follow-on funding.
- Valuations of businesses in, or connected to, the Core Areas may suffer. A US study, Financial protectionism, M&A activity, and shareholder wealth¹, has shown that foreign takeovers of firms affected by the Foreign Investment and National Security Act of 2007 (FISIA) declined by 68% compared to unaffected firms. Valuations of affected firms also fell compared to unaffected businesses.
- Certain strategic sectors may, by their nature, not match the risk appetite of a pool of potential investors and businesses may be forced to accept sub optimal terms. 'Chinese investors are coming into areas where other nations fear to tread' and 'At the stage of creation of IP there is a real-time, enormous influx of capital from China' were quotes from roundtable participants.
- The proposed regime could result in companies having to consider at a premature growth stage whether to raise funds on public markets. It may also result in more pre-conditional offers for listed companies, with the consequences of companies spending longer under a stage of siege and the cost of financing increasing.

Question 3. What are your views about the content of the draft statement of policy intent published alongside this document?

12. The statement of policy intent has an important role and we are keen to support the government to get this right. Appropriate safeguards in a proportionate regime will help maintain, to the public benefit, an open approach to international investment. By drawing on our members' experience in running, advising and investing in businesses, we make some suggestions below for improving clarity to the areas considered at risk. The objective is to avoid over-reporting (including after a bedding-in period), and to prevent bottlenecks while notifications are being assessed. We also focus on the need for effective communication of the policy.
13. Information that is currently included in the White Paper regarding sanctions and judicial oversight should be included in the final policy statement.

The scope of areas at risk

14. The areas at risk require more detail to be helpful to businesses, advisers and investors. Uncertainty due to the unlimited scope of the new regime could be reduced with more granularity, such as on the matters below:
- On infrastructure, in determining the line items in the Core Areas, account should be taken of other measures and powers available to the government as part of its entire national security strategy, before the proposed process 'kicks in'. As a general point on infrastructure line items, commentary would be useful on the points of the supply chain that could be considered at risk.

¹ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3147404

- More detail in newer areas brought in scope, for example, are all businesses that 'develop and design digital AI and ML technologies' in scope?
 - More detail on 'defence assets that have a dual-use purpose'. This category captures a wider range of assets than previously. The existing export notes are not sufficiently user friendly to be referenced by newly-caught businesses (and their advisers).
 - More commentary regarding businesses where it is not black or white if they are in scope or not.
 - More detail on the individual businesses or assets that the earlier green paper considered could be included in the scope of the mandatory notification regime, if that option were chosen, even though the wider sector that they operate in is not in scope.
 - The extent and circumstances in which commitments and investments by foreign states/parties in, or connected to, specific academic projects could be in scope – eg, Huawei's confirmation in June 2018 of a £1bn investment in the UK.
15. We believe that the unlimited nature of sectors, transactions and parties render the estimate of around 200 notifications annually an underestimate, beyond the initial period. ICAEW's sources suggest that deals between September 2017 and September 2018 in the Core Areas alone, ranged from 213 to 287. This means at least a deal a day being notified given that the figures do not include loan transactions, real estate deals or deals with key suppliers to businesses in Core Areas². The prospect of more deals than expected being notified should inform plans for an appropriate infrastructure and resources.
16. In the context of resource-planning, we note that in the US, CFIUS' workload has more than doubled in the past decade. Recent changes proposed to the CFIUS review timetable recognise that the process was often protracted, delayed and much longer than it 'claimed on the tin' (with information requests/ re-filings). It is now proposed to change/ extend the review periods. The budget of CFIUS has increased and it is also proposed that they start charging fees. It should be noted that this is in the context of a separate function which is generously staffed.

Communication of the policy

17. SMEs and early-stage or start-up businesses, eg, in new technology development or personal data, are unlikely to realise that they could be caught in the regime. Typically such businesses do not have the resources to engage lawyers and advisers to assist with notification and filings. ICAEW supports efforts to encourage investment in start-ups, early stage and scale up companies and technologies – actions to ensure that the business world is sufficiently informed and supported will help avoid strategies and events that could create national security concerns or risks.
18. The statement of intent can refer to how the government will promote the policy issues and its commitment to having a user-friendly, open channels process, to publishing ongoing updates and to carrying out a post-implementation review. Government support of industry-led awareness programmes and training would be desirable.
19. ICAEW has a record in convening support for campaigns to promote business awareness of government policies: for example, in **Cyber security in corporate finance**, ICAEW led an industry taskforce to create and disseminate market guidance and share good practice in managing cyber security risks in the context of transactions. ICAEW would be pleased to convene a taskforce, drawing on all participants involved in deals, to develop market guidance. Other professional bodies have already indicated interest in collaboration.

² If considered helpful, ICAEW will connect BEIS with the research sources

Question 4. Does the proposed notification process provide sufficient predictability and transparency? If not what changes to the proposed regime would deliver this?

20. The proposed process is seemingly more appropriate to a large, well-resourced business. It is not clear how business owners and entrepreneurs are expected to become aware of the policy issues and possible impact on them? Even larger business and their advisers may find it challenging to identify hostile actors with UK nexus. There need to be open channels for businesses or advisers to pre-consult on whether a potential trigger event could be in scope. The government might consider private notifications to businesses that, prima facie, fall into Core Areas in Annex A. Similarly the government could also identify real estate that is considered too close to, or connected to, sensitive sites. It should encourage and support industry initiatives for disseminating information.
21. As already mentioned, the policy should identify the party responsible for notification and the future compliance of a business that has been called in.

Question 5. What are your views about the proposed legal test for the exercise of the call-in power? Does it provide sufficient clarity about how it would operate?

22. We have no comment.

Question 6. What are your views about the proposed process for how trigger events, once called in, will be assessed?**Proportionality and communication with parties**

23. The process should be proportionate and should recognise the impact on the investment process and transaction timetable and the costs to businesses called in. A proportionate approach implies a tiered system could be efficient – what could be manageable timescales and requirements for a traditional, mature business may overwhelm a SME in a newer sector, which has yet to commercialise its IP. Appropriate tiers could be based on scale (eg a business at IP development stage vs an infrastructure fund), or on the purpose for the funding (to pay wages of researchers vs to fund growth by acquisition).

Pre-consultation and guidance

24. Due to the extensive breadth of the new regime and the nature of the sanctions, businesses are likely to be advised to seek pre-approval or guidance in the majority of cases. It is important that the process anticipates this as guidance, even if qualified, might also be sought very early on. For example, in cases where there is not an agreed transaction – whether hostile, unsolicited or prior to approach – and where information that the buyer has about target or assets will be limited; or regarding possible consortium acquisitions, where the consortium is not fully lined up and, accordingly, information about whole consortium not fully available.
25. There are parallels with seeking clearance from HM Revenue & Customs, even where the tax position is relatively straightforward. This is also evident by the popularity of the EIS/SEIS advance assurance regime, as investors are difficult to attract to a business that has not received such clearance. An appropriate system might be akin to the ability to pre-consult the Takeover Panel, which is long established and effective. It provides certainty for parties to a deal and ensures timely notification of potential issues to the regulator. It should be noted, however, that an undesirable aspect of the CIFIUS pre-notification process, is that it can last for months.

Publicity

26. Publicity will be highly sensitive for both public and private companies and there needs to be alignment with rules and regulations for public company disclosures. However, particular consideration will be required of the timing for making public that a private business has

entered the process. Implications for a business could be wide-ranging and include the reduction in credit, disruptive action by key suppliers, slower payment by customers and concerns for the pension trustees. The impact on business reputation would imply that any publicity would be preferable at the end of a call-in period, together with the decision and, if any relevant, any remedies. There needs to be coordination with practice in other regimes and jurisdictions, for example, if the proposed sharing of information at EU level is implemented.

Question 7. What are your views about the proposed remedies available to the Senior Minister in order to protect national security risks raised by a trigger event?

27. We have no comment on the proposed remedies.

Question 8. What are your views about the proposed powers within the regime for the Senior Minister to gather information to inform a decision whether to call in a trigger event, to inform their national security assessment, and to monitor compliance with remedies?

28. The powers for the Senior Minister must not be capable of being exploited for reasons other than a risk to national security, as this would undermine the policy and fuel uncertainty. A governance process must ensure that there is accountability for decisions and any remedies imposed and consistency and fairness in the application of the Senior Minister's powers.

Question 9. What are your views about the proposed range of sanctions that would be available in order to protect national security?

29. We have no comment.

Question 10. What are your views about the proposed means of ensuring judicial oversight of the new regime?

30. We have no comment.

Question 11. What are your views about the proposed manner in which the new regime will interact with the UK competition regime, EU legislation and other statutory processes?

31. We would expect to see more detail on the interaction with the takeover timetable, how the regime would fit with the proposed EU regime and the timetable for approval of the new regime to ensure compatibility with EU principles.

32. It is worth exploring continuous access to the envisaged sharing of information between EU agencies on transactions which fall within the foreign direct investment screening process. This could equip the UK with valuable information and aid in speedier/ efficient assessment of cases.