BVCA response to the Sub-Committee inquiry: Information sharing by the Investment Security Unit (February 2023)

The British Private Equity and Venture Capital Association ("BVCA") is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 700 firms, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2017 and 2021, BVCA members invested over £57bn into around 3,900 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over two million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

Executive Summary

We understand the concerns regarding national security and supported the government's goal of implementing a national security regime. In terms of implementation, our impression is still that the National Security and Investment Act 2021 ("Act") is working as it is designed to do and so far, it has not yet hindered the majority of investment decisions. However, there remain a number of "teething" issues which are causing uncertainty and delay for investors, and we would recommend that steps are taken at this early stage to resolve these issues. If these matters are not clarified and issues not confronted, it is our view that the difficulties faced by our members will continue and could potentially lead to the UK becoming a less competitive location when it comes to attracting investment, impacting negatively on innovation and growth.

Our key recommendations to improve information sharing by the ISU include:

- Communication with parties during the review process and regarding the outcome. This could be achieved by introducing case officers for a specific notification process/investigation.
- Reducing timetables and removing the clock-stopping function to clear deals as quick as possible.
- Improving existing guidance to clarify matters and producing further guidance via engagement with the investor community. This should be done via the established Expert Panel.
- Regular reporting of statistics on notifications and call-ins.

Separately, the BVCA holds some reservations around the ISU's recent transition from BEIS to the Cabinet Office. The industry is concerned that decisions made within the remit of the Cabinet Office may be affected by political considerations, potentially losing focus on the value and benefit of an investment to job creation and innovation across the UK. We would encourage the Sub-Committee's inquiry to include this move to the Cabinet Office as part of its scrutiny work.

We have set out answers to the inquiry's three questions, including recommendations for reform, and would be happy to provide the Sub-Committee with further details.

Q1. How, and how effectively, does the Investment Security Unit (ISU) communicate with the firms involved in transactions? How could this improve?

(1) Overall, our members have found that the communication from and resourcing of the ISU is insufficient. The main feedback from members is that the ISU is inconsistent in their approach, at times slow to communicate and is not resourced adequately. Our understanding before the legislation was implemented was that the ISU would work closely with the business community to try and ensure a clear and efficient process, however members are often finding this is not the case and this lack of and inconsistent engagement with the business community is leading to further delays and uncertainty.

British Private Equity & Venture Capital Association
+44 (0)20 7492 0400 | bvca@bvca.co.uk | www.bvca.co.uk

(2) We continue to recommend that the government puts in place measures to help narrow the scope /have clearer drafted definitions of, in particular, the 17 specified sensitive areas of activity to assist all parties, as well as providing additional guidance and better engagement from the ISU.

Briefing papers and informal contact to discuss future acquisitions

(3) The ISU's response, more often than not, is to call for a notification without providing any explanations or giving appropriate consideration as to why a notification should be made. On some occasions, members have noted that they have been provided useful guidance only after a number of weeks, leading to uncertainty and delay in a transaction, which might due to time and cost pressures, collapse. In addition, the ISU has on occasion failed to provide a timeline for their response.

Timing of the initial review

(4) The ISU should aim to speed up the review of clearly benign deals, sure as purely internal reorganisations, where possible rather than waiting until the full 30 working days (6 weeks) to clear. There should be an expectation set to give confidence to businesses that benign deals are cleared in a shorter period of time. Similarly, the ISU should aim to accept notifications as complete as quickly as possible as this can unnecessarily extend timetables.

Adaptability of the ISU

(5) The ISU should adapt to begin giving views on interpretation of the NSIA in the absence of any judicial interpretation by the courts. Our members and their advisors would much prefer to have more detailed guidance, even if there is a risk that a court might subsequently disagree with it. For example, the CMA's jurisdictional and procedural guidance (CMA2) has around 30 pages of guidance dedicated to explaining how the CMA has interpreted its jurisdiction under the Enterprise Act 2002, very little of which is based on case law of the courts. This is all the more important given the extremely broad and vague wording of many provisions in the NSIA.

Interaction and formal contact with the ISU

(6) While some of our members found that the process went smoothly and that the information requests were proportionate, others had the exact opposite experience. The ISU, in some examples given, did not appear to be engaging appropriately with the notifying parties over and above stating that they have 30 working days to clear a transaction.

(7) During in-depth reviews, it has become normal for the only meaningful interaction between the parties and the ISU to be responding to a short information notice. We understand this is because the ultimate decision maker is the Secretary of State ('SoS'), and the ISU cannot speak on their behalf and risk giving the parties a steer as to the potential outcome of the investigation that may change as the investigation proceeds. However, investors would find it very useful to better understand the likely timetable of a review as it progresses. This can be particularly important where NSIA clearance is the final condition to completion and therefore an unexpected clearance decision can have implications for completion timetables e.g. finalising financing arrangements within a short period of time as set out in the transaction documents.

(8) Investors would also likely appreciate a better understanding of any potential concerns that have been identified and are being investigated. Such insight would allow the parties to better assist the ISU/SoS by proactively providing further information or documents that may aid their understanding and may expedite the review process.

(9) More generally, no named case handler is assigned to the investor, and no feedback or process updates are generally provided. We would advocate for a case officer to be assigned to each filing from the outset for any queries the parties have. The notification process is often

perceived by investors to be a "black box". Indeed, updates and reasons are not provided even when cases are called in, leading to a lack of clarity over the concerns and the eventual timeline. In contrast, other comparable screening regimes do allow for formal and informal contacts (see below for further information).

Accountability and transparency of the ISU

(10) A further concerning issue is around the decision to extend the reviews and the clock-stopping function, which impacts strict transaction timelines and causes unnecessary delay. This could be solved by amending the Act so that the clock is not automatically stopped on issuance of an information/attendance notice. Instead, and similar to the process in the UK's merger control regime, the SoS could be given the statutory power to stop the clock in the event that a party failed to provide a timely and/or complete response to a formal request. Alternatively, the ISU could be instructed to issue informal requests in the first instance, and only issue formal requests with clock-stopping effect if a party has failed to satisfactorily comply with an informal request.

Q2. What metrics and information should be used to assess the impact and effectiveness of the investment screening systems, and over what time frame?

Comparison against the original aims of the NSIA

(11) The NSIA White Paper[1] published in July 2018 described a successful foreign investment screening regime as one that includes certain mechanisms, features or reforms. We suggest that the operation of the NSIA to-date be considered against these. If the NSIA meets these standards, it may be considered to be operating effectively.

Assessment of investment into the UK

(12) To assess whether the NSIA has impacted the UK's attractiveness for foreign investment, the value of inward investment into the UK and the number of deals over the period the NSIA has been in force could be assessed and compared with previous years prior to the commencement of the NSIA. Given there would be many other economic and geo-political factors affecting this, the assessment would need to be done over a longer time frame to compare trends.

Regular reporting of statistics on notifications and call-ins

(13) In its 2022 NSIA annual report, the Government provided data on the number of mandatory and voluntary notifications received and accepted or rejected. The level of data published in the report is very helpful in assessing the impact of the NSIA. It would be helpful to transacting parties if these statistics could be published more regularly to better understand the impact of the regime, as it evolves in the first few years of operation. Given the regime's nascency, reporting at more regular intervals will help parties to identify and respond to any key changes or trends more readily. More granular statistics on, for example, the number of voluntary filings that were actively notified by the parties vs. those made at the request or invitation of the ISU, would also be helpful.

(14) In addition to the detailed data already published, it may be helpful to have data categorised by transaction type (i.e., whether the deal notified is an acquisition, merger, joint venture or internal reorganisation). Identifying 'technical' filings, (i.e., 'no issues' internal reorganisations which don't involve an acquisition or ultimate change of control but technically fall within scope of the NSIA) would be helpful, to assess what proportion of total notifications these low-risk transactions represent.

[1] National security and investment: white paper consultation (publishing.service.gov.uk)

Transparency about conclusion on jurisdiction

(15) Our understanding, is that the Government currently does not inform notifying parties of its conclusion on jurisdiction and will issue a clearance following a mandatory notification, without confirming if the transaction actually fell within scope of the mandatory regime. If the Government records (or started to publish) statistics about the number of mandatory notifications which were made despite being 'out of scope', this would give an indication of the effectiveness of the investment screening regime. If the number of 'out of scope' notifications is high, this would suggest that the NSIA legislation is somewhat unclear and parties frequently make precautionary filings, in light of the serious consequences for failing to make a mandatory notification when required.

Q3. What can the UK learn from the way other countries report on the work of their investment screening systems?

Communication with parties during review process and regarding outcome

(16) The lack of communication with parties during the NSIA review process has been one of the primary concerns of transacting parties and their advisers to date. This opacity is reflected (i) during the initial 30 working day review period; (ii) once a transaction has been called in for review by the Secretary of State (when little substantive insight is given on the nature of the ISU's concerns); and (iii) in relation to the final decision (notably where remedies are imposed).

(17) The ISU process in this regard compares unfavorably to experiences of engaging with foreign investment regulators in other jurisdictions (as explained below). Whilst many transacting parties would like the level of communication held with foreign investment regulators in other jurisdictions to also increase; in jurisdictions with more established foreign investment regulation regimes, such as the US, there is already a greater degree of dialogue between the Committee on Foreign Investment in the United States ("**CFIUS**") and the transacting parties.

(18) Similarly, the level of disclosure in the published copies of the final orders is limited, and insufficient for transacting parties and their advisers to fully understand the reasoning behind the Government's decision.

United States

(19) In the US, communications with the parties during the review process are generally limited to follow-up questions for the parties (which is similar to the ISU issuing RFIs), however CFIUS also responds to the parties' queries as to the status of the review process. In our experience, when advising parties' whose transaction is subject to a more thorough level of review under the NSIA, the ISU has not been willing to enter into a dialogue with the parties on the status of the review process. However, this would improve the process, increasing transparency and confidence in the regime.

(20) The process of agreeing remedies that will permit a transaction to be cleared is more collaborative. If CFIUS plans to seek mitigation conditions, they will orally describe the Committee's general concerns and describe mitigation conditions that, if accepted by the parties, will permit CFIUS to clear the transaction.

(21) If CFIUS wants the US President to prohibit a transaction, it is first required to send a letter to the parties notifying the parties that CFIUS plans to recommend that the President block the transaction. Under the NSIA, parties lack the same opportunity to respond to the Government's intention to prohibit their transaction.

Germany

(22) In relation to prohibition and conditional clearance cases, the German Federal Ministry for Economic Affairs ("MoE") provides the parties with a relatively high degree of transparency about its reasoning, to satisfy its legal requirement to provide reasoning for an administrative

decision. It will send the parties a detailed, reasoned prohibition decision, which is generally 20-30 pages in length. In cases which are conditionally cleared, a similarly detailed explanation of the regulator's decision-making process is provided to the parties. Also, during an in-depth investigation, there are several interactions with the MoE including meetings in which the MoE orally describes its preliminary considerations, which enables parties to a transaction to provide specific evidence and to offer tailored remedies for any residual concerns. If the ISU provided a report of its reasoning to parties, this would be helpful to parties which regularly engage in M&A transactions and whose businesses operate in sectors where there is some national security risk.

Public reporting

(23) The 'closed book' nature of the NSIA and the general lack of reporting by the ISU / Government currently makes it difficult for parties involved in a transaction to fully assess potential NSIA risks. The approach to public reporting by investment screening authorities of review processes is mixed across different jurisdictions, but there are some practices that the UK could learn from to improve transparency and accountability of the NSIA regime.

United States

(24) In terms of public reporting, CFIUS issues an annual report to the US Congress and an unclassified version is made public. The unclassified version includes aggregated statistical data on the number of filings, the countries from which investors come, the sectors in which investments were made, and the outcomes of the cases. While the NSIA annual report does contain similar statistics around number of transactions and sectors, it would be helpful to also have insight on the countries from which investors come.

Italy

(25) Under the Italian foreign investment regime, the Italian government publicly publishes an annual report setting out all cases that were notified and the corresponding outcome. The information provided about each notification is limited (but it still exceeds the degree of detail currently published about NSIA cases). The information includes a brief description of the transaction, the parties and an indication of whether the transaction was (i) considered not reportable, (ii) cleared unconditionally, (iii) cleared with conditions or (iv) vetoed. The Italian Government does not provide an indication of its reasoning publicly.

Germany

(26) In Germany, the MoE currently only provides quite limited aggregated annual statistics. However, it is considering its approach to reporting and giving additional guidance in the context of ongoing evaluation of the German rules. One element which is in consideration are substantive guidelines on the treatment of investment from certain geographies (e.g., China).

Lessons for the UK – BVCA recommendations

(27) The lack of reporting and transparency relating to the NSIA makes it difficult for parties to decide whether to make a notification where their transaction is a borderline case (i.e. where it is not clear if it falls within the mandatory NSIA regime, due to some ambiguity over whether the activities of the target entity could be deemed to fall within any of the 17 sensitive sectors). This may lead to parties making unnecessary filings out of an abundance of caution, causing parties an unnecessary burden and taking up ISU resources, which could be dedicated to reviewing transactions which clearly fall within scope of the regime.

(28) It would be helpful if the ISU could communicate with parties to explain why a transaction is out of scope of the NSIA regime entirely.

(29) The current level of disclosure by the ISU / Government is not sufficient for transacting parties to assess potential NSIA risks, in particular given that the statement for the purposes of section

3 of the NSIA on the exercise of the call-in power is quite high level. We do not think it would compromise attempts to preserve national security for the Government to publish more information about the transactions it reviews. For example, it would be helpful if the Government could provide a more reasoned explanation as to why it has called-in a given transaction using its discretionary call-in power.

(30) It would also be helpful if the Government could provide some additional detail on its analysis and rationale for making a clearance decision subject to certain conditions, or for prohibiting a transaction. If this information were publicly available, it would be beneficial to parties planning their investment strategies, allowing them to understand why certain assets or activities were considered strategic and/or threatening to UK national security. Alternatively, if parties anticipate that their transaction may require remedies under the NSIA, this additional public information would enable parties to consider and suggest remedies that may be acceptable to the ISU more proactively.

(31) In terms of reporting to the parties to a transaction which is prohibited or conditionally cleared, in a best-case scenario, the Government should consider providing a detailed report to the parties with precise reasoning, establishing a direct, causal link between the acquirer, governance rights, the target's activities and the identified threat to national security, which necessitates the transaction being prohibited or made subject to remedies.