THE
INVESTMENT
ASSOCIATION

National Security and Investment White Paper
Consumer and Competition Policy Directorate
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Dear Sir/Madam

RE: National Security and Investment: Proposed Legislative Reforms

The Investment Association ('the IA') champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting business and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £7.7 trillion for savers and institutions, such as pensions schemes and insurance companies, in the UK and beyond. The UK asset management industry is the largest in Europe and the second largest globally.

OUR POSITION ON THE PROPOSED REFORMS

The IA appreciates the opportunity to respond to BEIS's white paper consultation seeking views on proposed reforms to the Government's powers for scrutinising investment for the purposes of protecting national security.

We support efforts to address national security issues and, in that context, for the Government to have an ability to scrutinise national security implications of certain business transactions.

We look forward to working with the Government to ensure these reforms are implemented in a way that allows for UK markets to continue to function well, which will in turn help ensure the continued growth and prosperity of the UK economy.

While we support the intent of the proposals, there are a number of areas which we view with some concern:

- The potential for these powers to be used in a way that runs contrary to their stated focus on national security.
- A lack of clarity as to what could constitute a trigger event, which may be addressed by a mandatory notification scheme.
- A potential increase in political risk, which may result in an increased cost of capital.

- A differing definition of 'significant influence or control' to the widely used definition found in the Takeover Code.

- A lack of clarity around the definition of 'foreign investment'.

- The need to ensure that companies and investors would be able to make confidential soundings to Government prior to a transaction, and to ensure that they are not unfairly penalised, on the basis of this informal advice received from Government, for failing to submit a notification for which they are subsequently called in.

- The need to ensure that the screening and consultation process is adequately resourced, to avoid backlogs.

We address these points in more detail below. Please note that we do not respond to individual questions and instead provide a general overview of our views on the proposals as currently drafted – we hope that this is acceptable.

The IA is keen to work with the Government to find a solution that both protects national security and supports effective capital markets.

NATIONAL SECURITY

(Questions 1, 2, 3)

The priority for our members is that there is clarity of scope and process should the proposals be implemented. This will be to the benefit of the people making investment decisions, the companies involved in merger and acquisition activity, and Government Ministers and officials having to make judgments on national security grounds. Currently however there are concerns that these proposals are too loosely defined.

Legislation drafted too loosely, or lacking in a properly defined scope, has the potential to be used for a short-term objective which may run counter to the initial intention of the legislation. This reduces legal certainty, and as a result asset managers may be deprived of the confidence they need to make long-term decisions for the benefit of the individual savers and institutional investors who are their clients, with a resultant negative impact on the wider functioning of UK markets.

First and foremost, investors need to be confident in the application of the proposed powers and that there are safeguards in place to make sure that they are used for **national security purposes only**. It is important that these powers, which under the proposals will be broader than those under the Enterprise Act, are not used for broader political purposes.

The IA therefore welcomes the Government's statement that the new regime is indeed focused on national security, and does not include wider issues of public interest or the national interest. Legitimate public interest questions may well arise during a merger or acquisition. However the question of public interest is not the same as that of national security, and it is important for the success of national security objectives that other public interest concerns are not allowed to confuse the focus.

It is critical that in order to ensure that future Governments abide by this commitment, that it be enshrined in legislation.

We would therefore encourage the Government to include a strict definition of national security in the legislation, rather than, as at present, referring to the 2015 "National Security Strategy and Strategic Defence and Security Review", as this definition is reviewed, and thus may change, on a regular basis. One option may be to define the scope of core and non-core assets that may be subject to review, as is already done in other jurisdictions including France

and Germany. Should the Government feel in future that this legislation's definition of national security is no longer appropriate, it would then have the ability to amend the legislation following an appropriate period of consultation and debate. This would provide the government with the necessary level of flexibility while providing investors and companies with greater legal certainty and helping to remove unnecessary impediments to the smooth functioning of the markets.

TRIGGER EVENTS

(Questions 1, 2, 3)

When making an investment, investors need to know if an investee company or potential investee company could fall into scope, and whether given M&A activity would constitute a **trigger event**.

The additional potential time and cost associated with an acquisition where national security is a consideration needs to be factored in to investment process, particularly if an investor needs to assess the likelihood of a potential merger or acquisition being blocked on national security grounds.

Under the voluntary notification scheme proposed in the white paper, investors may not always be clear as to whether this is the case. If the scope of potential intervention on national security grounds is not clear then a cautious investor may steer clear of an investment which they (perhaps incorrectly) judge to have the potential to be subject to intervention. This may, for example, mean that an innovative company in a manufacturing sector is deprived of the investment that it needs to grow.

We therefore welcome the Government's draft Statement of Policy Intent, which provides some guidance as to the scope of these proposals. Still, the scope of the proposals remains wide ranging and we request that the Government provide as much clarity as possible.

For example, we note that as part of the consultation the Government sets out five trigger factors which could potentially be included in the legislation, which would enable the Government to scrutinise acquisitions of control more closely to examine for national security risks. While some of these factors include strict thresholds, others relating to the acquisition of 'significant influence or control' over an entity or asset are not rigidly defined.

The draft Statement of Policy includes a number of examples of what might constitute 'significant influence or control'. However the Government notes that this is a "non-exhaustive list".

Similarly, while the Statement of Policy provides a list of examples of the types of entities and assets most likely to raise national security concerns, the Statement also notes that national security risks could arise from trigger events elsewhere in the wider economy.

The Government has significant flexibility under the proposed legislation to determine what constitutes a trigger event, and as a result the scope of activity that may be captured has been disproportionately increased from the current system. For example, we note that under the current proposals the government expects an increase in the number of transactions reviewed on national security grounds from two or three a year under the current legislation to 200 notifications, with half of those called in for further review.

As such it makes it very difficult for investors to determine whether a merger or acquisition would fall under the scope of the proposed legislation, which in turn will make it difficult and extremely resource intensive to set up appropriate monitoring and reporting functions. It also means investors will be less confident as to the level of political risk associated with an investment.

On balance, we believe that the concerns outlined above would be best addressed through a mandatory notification scheme, to ensure that any national security screening regime is carefully and tightly defined.

COST OF CAPITAL

(Questions 1, 2, 3)

It is our fundamental role to help investors – both individuals and institutions – achieve their investment goals. That also means providing steady growth of investments over the long-term and giving consideration to the material long-term risks facing each investee.

Low political risk is an important factor in the efficient functioning of capital markets. Perceived political risk can lead to portfolio managers pricing in that risk when making investment decisions, increasing the cost of raising capital. This could have a particularly strong impact on smaller companies looking to raise scale up capital.

DEFINITION OF SIGNIFICANT INFLUENCE OR CONTROL

(Questions 1, 3)

"**Significant influence or control**" should be defined in such a way that it does not conflict with other market norms.

The IA recognises the Government's rationale for using over 25% of votes or shares as a trigger event threshold, rather than the 30% used under the Takeover Code's definition, but the Takeover Code definition continues to be the one most widely used and understood by the market with regards to acquisitions.

Moreover, the change in threshold to 25%, operating in conjunction with the regulatory requirements of the Takeover Code, will result in companies having to file additional regulatory disclosures at multiple thresholds, as well as having to have additional monitoring conditions in place to identify when those thresholds are reached. This will require significantly increased resource, something which will particularly impact smaller firms. As such the IA recommends that the proposed threshold be altered to bring it in line with the Takeover Code.

FOREIGN INVESTMENT

(Questions 1, 3)

The definition of "**foreign investment**" needs to be clear and specific.

Many of our members are global investment managers with client-bases worldwide and in the UK, and considerable UK operations and heritage. This may have significant impact on their investments if they inadvertently fall into a mandatory notification scheme due to their global businesses. Investors will require clarification as to whether it is the location of the investment manager, investment operations or beneficial investor which are the threshold for triggering any national security intervention.

Global asset managers, whose ultimate holding companies are based in the UK, will need assurance that they will not be caught as foreign investment even if some of their clients (and beneficial owners of their investments) may be based overseas.

CONSULTATION

(Question 4)

As part of ensuring a clear and transparent process, we welcome the Government's commitment to allowing companies and investors to make **confidential soundings** to government prior to a transaction so that they have clear visibility on whether the transaction may trigger notification or call-in and understand what the procedure will be.

We note however that this this is to be considered informal advice and not a substitute for submitting a formal notification. Companies or investors therefore run the risk of being penalised for failing to submit a notification following informal advice from the Government. This in turn greatly increases the legal uncertainty of companies and investors, and may act as an unnecessary barrier to merger and acquisition activity.

RESOURCE

(Question 6)

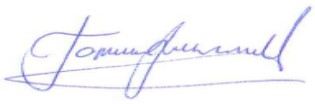
The IA welcomes the Government's commitment to a prescribed period of time in which to assess potential national security concerns, namely 30 working days, potentially extendable by a further 45 working days.

We note that in the white paper the Government notes that it expects to examine 200 notifications per year, an increase by an order of magnitude on the current system, and call in around half of them. The IA stresses that a**dequate resourcing** of the screening process, as well as to the informal advice process, is essential to ensuring a quick turnaround time and that markets remain efficient.

To this end investors welcomes reassurances that the Government will increase its resources dedicated to 'market monitoring' and invest in the tools and systems necessary, and request that resource levels are kept under regular review to ensure they are appropriate.

We would welcome the opportunity to work with the Government to make sure that these measures are defined in such a way that they both protect national security and support effective markets.

Yours sincerely,



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