

## PROPOSED NEW UK NATIONAL SECURITY AND INVESTMENT REGIME – IMPLICATIONS FOR LOANS AND RELATED COLLATERAL

Under the proposed national security and investment regime announced by BEIS in its July 2018 [White Paper](#), loans are capable of being notifiable investments and of being called in by the Government for national security screening if they give rise to or may give rise to national security risks. Although the White Paper makes it clear that, "the overwhelming majority of loans raise no national security concerns", it also makes the point that the Government must be able to intervene in cases where the loan itself or the underlying collateral are used as vehicles through which national security may be put at risk. This briefing note summarises how the Government intends to bring certain loan transactions under the national security screening regime and explores some of the issues arising out of this proposal. A fuller Clifford Chance briefing which examines the proposed new regime more generally can be found [here](#).

The Government is seeking responses to the proposals in its White Paper by 16 October 2018 and will use those responses to refine the proposals ahead of the introduction of primary legislation.

### Loans and related collateral as trigger events

The White Paper expressly states that loans and related collateral may, in certain circumstances, constitute "trigger events" that would be reviewable by the Government and, potentially, subject to remedies to mitigate any national security risks that are identified. The Government is concerned that a loan relationship and/or the enforcement of collateral could result in a lender that is hostile to the interests of the UK gaining "significant influence or control" over one or more obligors or one or more assets of national security interest.

As well as setting out in general terms the elements of a transaction that could potentially lead to national security concerns, such as the acquisition of more than 25% of votes or shares in an entity, the acquisition of more than 50% of an asset or the acquisition of significant influence or control over an entity or

#### The Proposal and Loans/Collateral

- Proposed new national security screening regime brings loans and collateral of any size in scope.
- Parties to a loan transaction/collateral required to assess whether national security concerns arise based on very broad trigger events.
- Government has power to review transactions and impose conditions, block a transaction or require it to be unwound if national security concerns are raised.
- The Government is seeking responses to its proposals before 16<sup>th</sup> October 2018.

asset, the White Paper specifically identifies the following three stages of a loan transaction as having the potential to lead to national security concerns:-

- entering into a loan agreement, if it contains provisions which give the lender significant influence or control over an obligor or asset. The White Paper suggests that this could arise if, for example, the loan agreement gives the lender unusual rights to receive sensitive, non-commercial information from the obligors. It is difficult to see how the receipt of information could result in a lender acquiring significant influence or control over an obligor or asset. Furthermore, it contradicts other statements in the consultation documents that preferential access to information is not of itself a trigger event;
- a default occurs under the loan agreement resulting in the lender exercising significant influence or control over an obligor or asset. An example of this given in the White Paper is the lender demanding its representative attend board meetings or the lender otherwise significantly influencing decision making following a default under the loan agreement; and
- acquisitions/enforcement of collateral resulting in the lender acquiring ownership or significant influence or control over the underlying asset.

At various stages of a loan transaction, parties are required to make an assessment of whether one of these three categories of event has occurred and, if so, whether national security concerns have been raised as a result. If an event gives rise to or may give rise to national security risks, the parties are encouraged to notify the Government with reasons. The notification regime is voluntary and there are no penalties for failing to notify. However, the Government will have the power to call in transactions that it has reasonable grounds for suspecting raise national security concerns and this power will be bolstered by an increase in Government resources dedicated to "market monitoring" and an ability to call for information to enable assessments to be made. In addition, if a particular stage of a loan transaction is called in for review before it has completed, an automatic prohibition on completion will become applicable from the moment it is called in until the end of the Government's review.

Once notified or called in, the Government will undertake a review of the loan transaction. If no national security concerns are raised, it will confirm that the transaction can proceed. If, however, the Government concludes that the transaction raises national security concerns, it has the option of allowing the transaction to proceed with conditions or, if its concerns cannot be dealt with through the imposition of conditions, it may block the transaction altogether. If the transaction has already taken place, the Government can require it to be unwound. The review process can take from 15 working days to 75 working days to complete.

## **When is a loan or related collateral a national security risk?**

To assist parties to loan transactions and other investments to make an assessment of whether or not a trigger event gives rise to or may give rise to a risk to national security, the Government has published a draft Statement of Policy Intent alongside its White Paper. The [Statement of Policy Intent](#) outlines three categories of risk that the Government will assess to decide

whether or not to exercise its call-in powers in relation to any transaction. Parties to transactions are also expected to base their assessment of whether or not to notify a trigger event on the guidance contained in the Statement of Policy Intent.

The three risk factors are identified as follows:-

- **Target risk** – that the entity (obligor) or asset is such that the acquisition of significant influence or control over it may pose a risk to the UK's national security due to the nature of its activities or the nature of the entity itself. Entities or assets in certain core areas of the economy (advanced technology, national infrastructure, critical direct suppliers to Government and emergency services and military and dual use technologies) are identified by the Government as most likely to pose a security risk. However, the Statement of Policy Intent is clear that a trigger event in respect of an entity or asset in other key areas of the economy or indeed the wider economy generally could also pose a risk to national security depending on the circumstances.
- **Trigger event risk** – that the trigger event gives the acquirer/lender the means to use the entity or asset to undermine the UK's national security. The trigger events for loans and related collateral have been described above and relate to the lender's acquisition of significant influence or control.
- **Acquirer risk** – that the person (lender) acquiring significant influence or control over the entity (obligor) or asset has the potential to use this to undermine national security. The Statement of Policy Intent does not identify the "persons" that the Government considers to be potentially hostile but does suggest that foreign nationality may make it comparatively more likely that an acquirer/lender poses such risks.

Although the Statement of Policy Intent contains useful guidance and illustrative examples, unfortunately there are no hard rules, thresholds or red lines for parties to loan transactions to work within in order to assess whether or not their loan transaction or collateral raises national security concerns. The Government is clear that as the national security landscape and risks are constantly evolving the Government requires maximum flexibility to change its assessment of the areas that are most likely to pose a risk to national security on a case by case basis.

## Key issues for loan transactions

### *National security assessment*

Although the White Paper states that the Government does not expect more than 200 notifications per year in total and that it will be rare for loans to raise any national security concerns, the trigger events and risk factors for loans and related collateral are broad and could potentially capture a large number of loan transactions. Lenders and borrowers may not feel able to assess whether or not a particular trigger event in relation to a loan transaction poses a national security risk particularly given that any sector of the economy may be caught and there is no guidance on who a "hostile lender" may be. Parties to transactions are not privy to the national security concerns of Government and cannot therefore be entirely confident in any assessment they make. Moreover, even if a loan arrangement will not become reviewable unless and until there is an acquisition or enforcement of collateral, lenders will often want to know of any potential obstacle to enforcing their collateral before entering into the loan agreement.

### Key Concerns for Loans/Collateral

- No clear parameters for assessing whether national security concerns arise.
- Potential for delays in enforcing security where lender acquires significant influence or control leading to national security screening.
- Unclear whether access to information is a trigger event. Confirmation required that standard LMA facility agreements and standard security documents are a safe harbour.
- Security over shares likely to require national security assessment once voting rights become capable of being exercised.
- The White Paper does not explain how the trigger events apply in the context of a syndicated loan where generally no single lender has control and security is held by a security trustee.
- Unwinding a loan transaction raises complex issues. It is unclear why this is necessary or how this will work in practise.

This may result in lenders and borrowers deciding to engage with the Government in order to obtain clearance with consequential delays to their transaction. Alternatively, given that notification is entirely voluntary, lenders and borrowers may simply plough on and wait for the Government to call them in. However, this could also have timing and other consequences particularly if the loan transaction has not yet closed or the enforcement of security has already commenced.

#### *LMA style facility agreements/standard security documents*

The White Paper emphasises that it will be unusual for the Government to conclude that significant influence or control has been acquired at the stage of entering a loan agreement or at the point of default. Although this is helpful, there is also a suggestion that the inclusion of unusual information provisions in a loan agreement could constitute a trigger event at the outset. It is unclear how the provision of information would give a lender significant influence or control over an entity or asset and so it would be helpful to have some clarity around this. In any event, if access to information is to be a trigger event, a statement that information disclosure requirements such as those contained in standard LMA information undertakings (which cover information regarding the financial condition, business and operations of any member of the group), and standard security documents (which usually allow for the secured party to call for information about the chargor's business, affairs and assets) would not constitute trigger events. Guidance confirming what is intended will be important for business certainty.

#### *Security over shares*

Where security is taken over shares, it is common for the secured party to be given voting rights once an event of default or acceleration event occurs. This is unlikely to constitute a trigger event allowing a national security assessment to be made at the outset but would rather be reviewable only where voting rights become capable of being exercised by a lender. A review at this stage would clearly impact the timing of the enforcement process leading to delays.

#### *Syndicated v Bilateral*

An assessment of whether a loan transaction raises national security concerns is likely to be more difficult for a syndicated loan than a bilateral loan with only one lender. In a syndicated loan context, it would be unusual for any single lender to acquire significant influence or control over an entity or asset or have the right to do so although a single lender is usually able to request information from the obligors as outlined above. Security is generally held by a security trustee for the lenders from time to time and no single lender is given the ability to enforce the security or take decisions relating to the secured asset. It would therefore be helpful to have guidance on how the trigger events for loans and related collateral are intended to apply in the context of a syndicated loan. For example, it would be helpful to see a clear statement from the Government that where a single lender in a syndicate of lenders is considered by the Government to be a "hostile lender", the other lenders in the syndicate would not be prevented from enforcing their security if such hostile lender has no independent ability to control or significantly influence the secured asset and/or the chargor even if such charged asset and/or chargor has national security implications.

#### *Unwinding a loan/collateral*

It is unclear how the Government intends to use its unwind powers in the context of a loan and/or related collateral. Indeed, it may be impossible to

unwind a loan arrangement where advances have already been made. Secured assets may have to be sold to repay the loan as part of the unwind which may or may not be sufficient to repay the debt. Where the loan has been used to make an acquisition, it is unclear whether the unwind power would also be used to unwind the acquisition, thereby also prejudicing the third party seller. It would be helpful to have some clarity from the Government on how it intends to use these powers in the context of loan transactions and the protection that will be afforded to third parties.

#### *Secondary transfers*

A secondary transfer or sub-participation (particularly where voting rights are given to the participant) of a syndicated loan participation from a "non-hostile lender" to a "hostile lender" may also raise concerns and require a new national security assessment to be made. An otherwise "clean" loan transaction could become of national security concern as a result of such transfer or sub-participation.

#### **Comment**

Of the 200 notifications expected by the Government each year, the White Paper suggests around 100 are likely to be called in for review. The vast majority of these notifications are likely to involve mergers, acquisitions and joint ventures. Even though a tiny fraction (if any) of the 200 notifications are expected to relate to loans, the Government has nevertheless for the first time expressly identified loans and related collateral as being capable of raising national security concerns. Parties to loan transactions cannot therefore ignore the new regime. However, it remains to be seen whether the legislation and associated guidance provides more clarity for the loan market to avoid some of the difficulties highlighted above. This may to a large extent be dependent upon the responses the Government receives to its consultation.

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