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National Security and Investment Act 2021, Part 4 – Impact on the Real Estate Finance Market

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In this month's edition of *REF News and Views* we are going to wrap up our series on the National Security and Investment Act 2021 (the "NSI Act") and explore the NSI Act's impact on the real estate finance ("REF") market.

In last month's edition of *REF News and Views* we **explored** the sanctions available under the NSI Act for non-compliance. We explained that the Secretary of State for Business, Energy and Industrial Strategy (the "Secretary of State") has wide-ranging powers to "call-in" transactions if:

- it reasonably suspects that a trigger event has taken place in relation to a certain type of entity (a "qualifying entity") or asset ("qualifying asset") in the UK in one of the designated 17 sensitive sectors (the "sensitive sectors"); or
- there are arrangements in contemplation which, if affirmed, will result in a trigger event taking place in relation to a qualifying entity or qualifying asset.

Further, we highlighted that the NSI Act regime is far-reaching with serious consequences for non-compliance. The Secretary of State has the power to impose remedies to address any national security concerns or risks, including:

- a transaction requiring mandatory notification to be void if completed without approval;
- the imposition of civil fines of up to the higher of £10 million or 5% of worldwide turnover for non-compliance, including competing a notifiable transaction without approval. This can include a "daily rate" fine (of up to £200,000 or 0.1% of turnover per day) to incentivise rapid compliance;
- civil enforcement including injunctions to enforce compliance; and
- criminal sanctions for non-compliance (including completion of a notifiable transaction without approval, non-compliance with an order, or non-compliance with a requirement to provide information), with penalties including fines, imprisonment and disqualification as a director.

Impact on the REF Market

How does the NSI Act impact on the REF market? At a holistic level, lenders should carefully consider the implications of the NSI Act in respect of their secured lending transactions, especially when it comes to the taking of share security and prior to taking any enforcement action.

When managing a transaction, counsel should factor in possible delays while waiting for ISU approval on the deal timeline and transaction execution. As inconvenient as any potential delays may be, the severity of the consequences of failure to obtain prior approval far outweighs this.

Consideration in Respect of the Type of Assets

While lending and taking security are not in of itself within the mandatory notification regime, the nature of the underlying transaction which is being financed needs to be carefully considered when assessing whether a mandatory or voluntary notification should be made.

Assets may be subject to the regime where they are closely linked to the activities of the sensitive sectors or in other areas that are closely linked to those sectors. Land may also be an asset of national security interest where it is, or is proximate to, a sensitive site (such as critical national infrastructure sites or government buildings) or because of the intended use of the land. This is perhaps the most important issue to consider in REF deals.

As we have previously noted, if there is a trigger event in relation to a property holding SPV that is a qualifying entity and that SPV carries on a particular activity in one of sensitive sectors in the UK, then this will fall within the mandatory regime and require notification.

Equitable Charges over Shares

One of the most relevant questions to the REF market regarding the NSI Act is whether the creation of equitable charges under secured lending transactions could constitute a trigger event under section 8(2) of the NSI Act such that a charge could be within scope of the mandatory notification requirements, because to do so would have far-reaching consequences.

Following discussions between Department for Business, Energy and Industrial Strategy ("BEIS") and the City of London Law Society ("CLLS"), BEIS offered the following **guidance**:

> "Whilst the grant of a security over shares could create an equitable interest in such shares, such an interest would not appear to grant any control over such shares, as referred to in section 8(1) [of the NSI Act], until the happening of an event that would provide control. Therefore we do not think this falls within the scope of mandatory notification until such an event that would grant control.
>
> Notwithstanding the above, the Government is considering whether any further clarification is appropriate and, if so, what format that should take."

Accordingly, on the basis that any equitable share charge would not appear to grant any control over such shares unless an event providing control occurs, a secured lender would not need to notify or obtain pre-clearance from the Secretary of State at the point of creation/grant of such share charge, even if the shares relate to a qualifying entity. We would expect that the majority of share changes in REF deals are structured on this basis.

However, it should be noted that any enforcement action could be also be a triggering event requiring BEIS approval. This is worth considering as it may affect the timing of the enforcement of the security as a lender may need to seek approval from the BEIS in order to transfer or sell the shares in question.

In this regard, we would strongly suggest that lenders seek specialist advice at the point of taking security and prior to any enforcement action.

Closing Thoughts

We would like to conclude our NSI Act series by pointing out that the NSI Act presents a narrow but deep risk. Lenders and investors should give due consideration to the NSI Act in order to protect their transactions and officers from potential criminal liability and other significant punitive measures. They should also ensure that they are cognisant of the new rules given the broad scope of the mandatory notification system under the NSI Act.