In Practice

Authors Jeremiah Wagner and Kamal Dalal

Don't forget about the NSIA: potential implications for securitisations

In this In Practice article, the authors explore some practical steps to address NSIA compliance risks for securitisation transactions, including:

- the importance of due diligence and determining if a transaction falls within scope of the NSIA's notification requirements;
- considering if a voluntary notification is necessary to mitigate call-in risk;
- structuring security provisions to avoid potential pitfalls; and
- building in contractual provisions to ensure compliance by transaction parties.

The National Security and Investment Act 2021 (NSIA), which came into effect on 4 January 2022, marked a major expansion of the UK government's oversight of investments on national security grounds. While market participants may have initially assumed the NSIA would have limited impact on most securitisation transactions, under certain circumstances notifiable or other in-scope acquisitions can arise. This In Practice article examines some possible scenarios of application and identifies practical steps which could avoid potential pitfalls.

APPLICATION OF THE REGIME

The NSIA regime confers intentionally broad powers of scrutiny and intervention to the Secretary of State for the Department of Business, Energy, and Industrial Strategy (BEIS) over acquisitions of certain entities or assets. The regime focuses on 17 specified sectors of the economy in which national security risks are considered to be high, including technology-related sectors, suppliers to the public sector, data infrastructure, defence, transportation, energy and civil nuclear. An acquisition of control – in the form of shareholdings or voting rights above prescribed thresholds – of an in-scope entity carrying out activities in one or more of the specified sectors triggers a mandatory notification and the acquisition cannot occur until clearance from the Secretary of State has been received.

The BEIS is also able to call in for review other in-scope acquisitions for trigger events occurring on or after 12 November 2020 if they carry a potential security risk. Acquisitions of control or material influence over in-scope entities undertaking activities closely linked to one of the specified sectors are most likely to be called in, although the net can be cast wider to cover all sectors of the economy. An acquisition of assets, including land, tangible moveable property and intellectual property, in, or with ties to, the UK may be in scope if the acquisition would enable the acquirer to direct or control how the asset is used.

Following its review of a contemplated or completed acquisition, the Secretary of State can require any remedies deemed necessary to address the security concerns identified, including rendering the transaction void. On the other hand, if the Secretary of State confirms approval, there should be no further risk of the deal being called in. Parties can make a voluntary notification when potential security concerns arise or as a way of seeking comfort that the transaction will not be called in.

PRACTICAL CONSIDERATIONS

The starting point for any financing is to assess whether it falls within scope of the mandatory regime or whether it is likely to be called in such that a voluntary notification is advisable. If there is a substantial NSIA risk, parties should explore remedies to ensure that the deal is commercially viable and consider including an obligation on the relevant party to comply with any mandatory notification or obtain pre-approval. If such a notification is a condition precedent, the deal timetable should factor in the BEIS review period.

In the context of a securitisation, any assessment should cover the transaction parties, security package, assets being securitised and underlying obligors of those assets. Securitisations of mortgages or lease receivables, for instance, may be within scope if the underlying property is located in the UK, and is mortgaged or leased to entities active in a specified sector. Existing or new security over in-scope entities or assets may also be caught if taking or enforcing the security interest results in an acquisition of control or material influence.

Parties should be particularly careful when share security is taken over an in-scope entity. Generally speaking, a mandatory notification would only be triggered upon the acquisition of shares or voting rights attaching to shares of the in-scope entity. When taking security, it would be unusual for a trigger event requiring notification to occur, unless security is taken in such a way that confers the acquisition of control or material influence (for instance, if the security agent or trustee has the power to exercise shareholder voting rights), which can be addressed by delaying the trigger for the transfer of voting rights until a notification has been made. When enforcing security however, it is common for voting rights attached to the secured shares to transfer to the security agent or trustee automatically. Where this applies, it may make sense to require a notification to be made before any enforcement action is taken or the security agent or trustee is able to assume shareholder voting control.

Parties should also assess the structure holistically and consider whether any party could be viewed as having control or a material

influence over the policy of an in-scope entity. For instance, if a servicer or back-up servicer is appointed to assume the management and decision-making functions of an in-scope entity, or a group of investors or noteholders are viewed as exerting material influence, these scenarios could fall within a grey area of the regime and a voluntary notification may be warranted.

Finally, parties should be mindful that intra-group transfers and corporate reorganisations can trigger a notification requirement. This may be relevant in the context of securitisation where, for instance, the borrower or issuer special purpose vehicle (SPV) is a subsidiary company and in-scope assets are transferred within the corporate group, or an intra-group transfer of in-scope assets occurs prior to an orphan SPV being brought into the structure.

TAKEAWAYS

NSIA risk should comprise part of the due diligence process in early deal stages and be assessed by reference to the specific facts of the transaction. Securitisations can give rise to notifiable acquisitions or other in-scope acquisitions through a number of avenues, including enforcement of rights under a security package. In certain cases, it may be prudent to notify and obtain the approval of the Secretary of State prior to enforcement to avoid call in risk. However, it is also possible at the outset to structure the security arrangements in such a way as to avoid the need to notify on enforcement. Given that the interpretation and implementation of the NSIA is likely to evolve over time, cautious flexibility seems to be the most sensible approach at this stage. ■

Biog box

Jeremiah Wagner is a partner in the Structured Finance and Securitisation Practice at Latham & Watkins, based in London. Email: jeremiah.wagner@lw.com

Kamal Dalal is an associate in the Structured Finance and Securitisation Practice at Latham & Watkins, based in London. Email: kamal.dalal@lw.com

This article is not intended to be relied upon as legal advice.