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Public Bill Committee

NATIONAL SECURITY AND INVESTMENT BILL

Second Sitting

Tuesday 24 November 2020

(Afternoon)

CONTENTS

PBC (Bill 210) 2019 - 2021

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not later than

Saturday 28 November 2020

The Committee consisted of the following Members:

Chairs: † Sir Graham Brady, Derek Twigg

† Aiken, Nickie *(Cities of London and Westminster)* (Con)
† Baynes, Simon *(Clwyd South)* (Con)
Bowie, Andrew *(West Aberdeenshire and Kincardine)* (Con)
Fletcher, Katherine *(South Ribble)* (Con)
† Flynn, Stephen *(Aberdeen South)* (SNP)
† Garnier, Mark *(Wyre Forest)* (Con)
† Gideon, Jo *(Stoke-on-Trent Central)* (Con)
† Grant, Peter *(Glenrothes)* (SNP)
† Griffith, Andrew *(Arundel and South Downs)* (Con)
† Kinnock, Stephen *(Aberavon)* (Lab)
† Onwurah, Chi *(Newcastle upon Tyne Central)* (Lab)
† Tarry, Sam *(Ilford South)* (Lab)
† Tomlinson, Michael *(Lord Commissioner of Her Majesty's Treasury)*
† Western, Matt *(Warwick and Leamington)* (Lab)
Whitehead, Dr Alan *(Southampton, Test)* (Lab)
† Wild, James *(North West Norfolk)* (Con)
† Zahawi, Nadhim *(Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy)*

Rob Page, Yohanna Sallberg, *Committee Clerks*

† attended the Committee

Witnesses

Dr Ashley Lenihan, Fellow, Centre for International Studies, London School of Economics

Michael Leiter, Partner, National Security; CFIUS and Foreign Investment Reviews; Cybersecurity and Privacy; Congressional Investigations and Government Policy; Skadden, Arps, Slate, Meagher and Flom LLP and Affiliates

David Petrie, Head of Corporate Finance, Institute of Chartered Accountants in England and Wales

Chris Cummings, Chief Executive, Investment Association

Public Bill Committee

Tuesday 24 November 2020

(Afternoon)

[SIR GRAHAM BRADY *in the Chair*]

National Security and Investment Bill

2 pm

The Committee deliberated in private.

Examination of Witness

Dr Ashley Lenihan gave evidence.

2.3 pm

Q36 The Chair: Members can sit in any seat where there is not a "Do not sit here" sign. Any Member sitting in the Public Gallery should stand by the microphone when they wish to speak.

We will now hear oral evidence from Dr Ashley Lenihan from the Centre for International Studies at the London School of Economics. Thank you for joining us today. Can you hear me now?

Dr Lenihan: I can hear you now.

Q37 The Chair: We have until 2.45 pm for this session. Will you please introduce yourself for the record? I will then call Committee members to ask questions.

Dr Lenihan: First, let me thank the Committee for including me in today's evidence-gathering session. My name is Dr Ashley Lenihan and I am a fellow at the Centre for International Studies at the London School of Economics, as well as an associate at LSE IDEAS. My research for almost 20 years now has focused on foreign direct investment and national security.

The Chair: Thank you very much.

Q38 Chi Onwurah (Newcastle upon Tyne Central) (Lab): Thank you very much, Dr Lenihan, for putting your expertise at the disposal of the Committee. I am particularly interested in your expertise in the international aspects of the debate. As you are aware—the Bill responds to this—a number of the UK's allies have national security and investment screening regimes, and almost all of them have updated their regimes in the light of the changing geopolitical and technological contexts. From your comparative work, what governance and decision-making structures have you found others adopting to ensure that all relevant Government expertise shapes national security and investment decisions? Are they appropriately reflected or considered in the Bill?

Dr Lenihan: That is an excellent question. To answer it, I will first step back for a second and say that the Bill is a very important step in the UK's alignment with its closest allies on this issue, and especially the Five Eyes, because there is clear evidence that states are trying to use the market and companies over which they have control and influence to gain economic, technological and even military power in foreign investment. During times of economic downturn and crisis when asset prices are low, the opportunities for that type of behaviour increase. Hence, we have seen these modifications to regimes not only in the West, but outside the West as well.

I think one of the most important elements of regimes as they have evolved—especially among the Five Eyes, but among our NATO allies and even in Russia and China—is the move to ensure that review mechanisms have the institutional capacity and resources that they really need behind them. Part of this institutional capacity usually involves a multi-agency review body of some type.

There is always a lead organisation, and in the West—especially in the US, Germany and France—these tend to be in Treasury or in business or trade Ministries, and that lead body, like the Department for Business, Energy and Industrial Strategy in the Bill, receives the information and handles the day-to-day activity. However, in the US with the Committee on Foreign Investment in the United States, the idea behind having a multi-agency review body with multiple agencies and Departments across vast areas of Government is that you have the ability for regularised monitoring and feed-in from these agencies across the spectrum of possible threats, and you have dedicated staff within those agencies who have the necessary security clearances, training and specialised knowledge over time to keep an eye on potentially risky transactions and bring them to the awareness of the lead agency.

One of the key elements of CFIUS that has been very positive is that, as it has evolved, it has brought in more agencies, not less, so you have multiple opinions on the same potential transaction being brought to light and discussed before any decision needs to be taken by a Secretary or Head of State, depending on the question. In CFIUS, that responsibility ultimately lies with the President, but the idea is that you have had a multiplicity of views and, under the Foreign Investment Risk Review Modernisation Act—the most recent update of US legislation—you have an ensured national security risk assessment made by the head of intelligence on detailed investigations of certain transactions.

The idea behind this is that—hopefully—any decision made will be viewed by the public as one that is truly based on national security concerns because of the debate that had to take place behind the scenes. That lowers the risk of politicisation and intervention, and again heightens the possibility of actually catching risky transactions in a way that otherwise can be difficult.

One of the great examples of transactions in the US caught not originally in the regularised monitoring process, but by a CFIUS employee in one of the agencies, was the unwinding in 2011 of Huawei's purchase of 3Leaf, which was a US-based cloud computing technology company that had gone bankrupt. The assets, employees and patents had been purchased by Huawei—bankruptcy assets were not consistently monitored by the regime at that time. The purchase was caught by a Government staffer who happened to notice on his LinkedIn account that somebody whom he knew, who had partially run 3Leaf, was now listed as a consultant for Huawei. That transaction had to be reviewed and retroactively unwound. At that point, of course, one must assume that the bulk of the damage had been done, but it goes to show the importance of having not just one agency looking at these cases and being responsible; a multiplicity is needed across the piece. If I have any concerns with the Bill, my primary concern would be that the institutional capacity and resources behind the review regime are not made clear.

Q39 Chi Onwurah: Thank you, Dr Lenihan. That is absolutely fascinating. The need for different agencies to be involved needs to be recognised.

In terms of your work on investments, and the investment regime, is there not a risk that it ends up capturing a host of investment transactions? I am particularly thinking of the burden and impact on our innovative tech start-ups. The likely definitions of the sectors to be involved include artificial intelligence and data infrastructure. Based on your experience of other countries' introduction of new investment screening rules, have you found patterns in how similar changes have affected foreign direct investment, and potential trade deals, which is a topical subject? Do you have any thoughts on ways to mitigate the burden and impact, particularly on start-ups?

Dr Lenihan: The Bill is arguably broader in scope on call-in powers than some other foreign direct investment regimes—I would argue that these perhaps even include the US regime—because it does leave wide latitude for call-in powers. The Bill also covers trigger events that are initiated by all investors, both domestic and foreign, and that is truly rare among Western FDI review regimes that are focused on national security. Usually, the concern is to focus the regime on investments from foreign-owned, controlled or influenced entities. Domestic entities and acquirers that have, for example, ultimate foreign ownership or influence in some ways should be able to be caught by any well-institutionalised and resourced regime. I am not sure why it is that we do not actually see the word "foreign" in the Bill, even though it is supposed to be based on foreign direct investment. Perhaps that is a concern about potential domestic threats down the road, but either way, it will lead to a much larger volume of mandatory notifications than most other national security FDI regimes—the US, Germany, Australia and other countries. Almost 17 have made changes in the past couple of years, and these have increased and been modified since the covid pandemic.

I understand that the legislation may be written as it is to include domestic investors, perhaps to avoid appearing to discriminate against foreign investors. I would suggest that that is probably too broad a formulation for focusing on and identifying real risk. The EU framework for FDI screening encourages its EU members to adopt mechanisms that do not discriminate between third-party countries, but that does not mean that it takes the word "foreign" out of its legislation to target foreign investments as opposed to domestic ones. Part of that is about the volume of transactions.

One thing I would highlight is that FIRRMA expanded the scope of covered transactions to include non-controlling investments of potential concern, as well as any other transaction or arrangement intended to circumvent CFIUS's jurisdiction. But because it has had more cases to review on a detailed level in the past two or three years than in its history, since 1975, a major element of that Act is, again, around staffing and resources. There is a specific provision in FIRRMA, which is very clear that each of its agencies needs to hire under-secretaries in each agency just to be dedicated to this task.

There are two elements. An inter-agency review team is needed. You need enough staff to actually handle and catch all the risks. You the need the proper resources to do so—the right access to the databases, the right security clearances, the right training. On top of that, the volume of mandatory notifications will be increased by the fact that this is not just focused on foreign investment. I do not think there is much you can do about the foreign cases that you will get. There will be a high volume of those, and you need to be ready for them, but it is an important national security risk that needs to be dealt with.

Q40 The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Nadhim Zahawi): It is a pleasure to serve under your chairmanship, Sir Graham. Dr Ashley, considering your experience of other countries—we talked about the US at length in the first couple of questions—such as Japan and Germany, what are your views on the retrospective powers under our Bill?

Dr Lenihan: Personally, I think they are fine. I know that might not be a popular answer with some. Germany, France and even parts of the EU framework set up this five-year retroactive for cases. I think that that is at minimum important. Other countries, such as China, Russia and the US, do not place any limit on retroactivity. I would have to check up on Australia and Canada, but there have been cases that have gone beyond a year there. Under the original Government White Paper, the idea of having only a six-month period, whether or not you have been notified, is quite dangerous, because there have been cases that were well known where they have been caught after that point.

Some of my examples are from the US. The reason for that is that it is one of the longest-standing and most institutionalised regimes. It is also one of the most transparent, from which we know most about the cases that have gone through it. I have looked at over 200 cases of this type of investment over a seven-year period in the US, UK, Europe, China and Russia. One case that stands out in the US is the 3Leaf acquisition by Huawei, which was caught almost at the year mark. Another good example that went over the one-year mark would be the review in 2005 retroactively of Smartmatic, which was a Venezuelan software company, and its purchase of Sequoia Voting Systems, which was a US voting machines firm. Smartmatic was believed to have ties to Chavez. However, that acquisition completed without knowledge of CFIUS and it was not actually able to be unwound until 2007. At that point, you worry about what has happened, but at least you do not have the ongoing concern.

You do need flexibility. With the volume of notifications and the learning curve that the investment security unit will have to undergo, or whatever the final regime truly looks like, it will take time to get the team in place and get the knowledge and systems down, to accurately catch even the most obvious investments that are of concern. Dealing with the kind of evolving and emerging threats we see in terms of novel investments from countries such as China, Russia and Venezuela needs the flexibility to look at retroactively and potentially unwind transactions that the Secretary of State and the investment security unit were not even aware of.

One thing is that for mergers and acquisitions transactions, which are historically what have been covered under these regimes, across Europe, Australia, Canada, Russia, China and the US, all the systems that have been used—the M and A databases: Thomson ONE, Zephyr, Orbis—take training, but they only cover certain types of transaction. They do not cover asset transactions; they do not cover real estate transactions, which are of increasing concern, especially for espionage purposes.

It is going to take time, and I believe that flexibility really needs to be there. It can always be reviewed in the future, but I do not think that so far foreign investment has been deterred in any way in countries that have that retroactive capability. To limit the UK's capacity to protect itself for some kind of strange feeling that we need to be perceived as being even more open than everybody else when under threat is not really wise at this time.

Q41 Matt Western (Warwick and Leamington) (Lab): It is a pleasure to serve under your chairmanship, Sir Graham. Dr Lenihan, I am keen to know more about whether, other than in the US, you have seen good exemplar approaches to screening investments into these sectors; we spoke about Japan and Germany a moment ago. Can you give examples which we might learn from?

Dr Lenihan: I do think the US system is the most institutionalised that we have, and the best at the moment. That being said, Germany's system is very good; it has caught quite a bit. The German system has also been very good about regularly updating, changing and adapting its regulations as it sees new emerging threats to itself. They seem to have good feed-in across Government and they are exceptionally good at co-ordinating with other states in terms of information of concern.

In terms of national security review, Canadian and Australian systems are quite good. The problem with those systems is that they tend to do national interest reviews at the same time or in tandem with their national security reviews. Over the long term, including national interest in the regime has had an impact on how they are perceived in terms of their openness to foreign direct investment abroad. In the OECD's FDI restrictedness index, Canada and Australia rank far lower than the US, the UK, Germany and France, and I think this is because of their inclusion of national interest concerns. Similarly, on the World Economic Forum's global competitiveness index, they rank far lower. That does not provide investors with the type of clarity that they need. In general, we see that investors tend not to be dissuaded from investing just because there is a new foreign direct investment regime, as long as that regime is seen to have clear regulatory guidance, is transparent, and is applied consistently over time.

France sometimes gets quite a bad reputation for economic nationalism, but its review mechanism is also quite good at catching potential threats to national security. Japan is an interesting case. It has been so restrictive for so long that it is a little harder to compare with the other western countries. Its system has been tied in again to an overarching inward investment regime that has been restrictive towards foreign investment for other means beyond national security, so I find that country to be less of a comparator for these purposes. I hope that answers the question.

Q42 Simon Baynes (Clwyd South) (Con): It is a pleasure to serve under your chairmanship, Sir Graham.

I have found your comments particularly interesting, Dr Lenihan. My own background is in the financial world, where I was involved in cross-border M and A and quoted equity transactions. I fully accept the premise of the Bill, which I think is important and has to be put into effect, and I draw encouragement from what you are saying about other regimes, but I am still left wondering a little bit whether, in practice, it will be really quite difficult for us to put into effect. Your point about the necessity of expertise among staff is crucial. Having sat at the centre of the process, I recognise that the point you make about a huge amount of information flowing across, especially in respect of unquoted companies, is very important; often, there is not much established information in the public domain. That first point is very important. The second point is that there is a very complex mechanism of market sensitivity as well. I do not quite know how this system intervenes with that. Also, within the UK itself there is a culture of openness, which has been touched on before, and in some respects we are a very different country from the others, particularly given the strength of the City of London. We therefore have the ability to transact in a way that some other countries do not, and a different culture.

The other point I wanted to raise and to hear your comments on is that there is a danger of political interference. I know that that is not the intention, but it must be a hazard in this process. What happens if the Government get it wrong about a company? Could not that be interpreted as political interference rather than seeking to establish a security risk?

Dr Lenihan: I started my career in mergers and acquisitions in aerospace and defence M and A, in London. I think you make an important point: the UK has historically been the most open country to foreign direct investment on most indices and indicators. That perception is strong, and I do not think that that culture of open investment will or should change with the introduction of the regime. To the contrary, it actually gives you one of the best starting points that any country has to do this.

As I said, on the whole, in the Bill as written, and in the statement of policy intent behind it, it is very clear that the powers for review and intervention should be used only for an identified risk of national security, and not on the grounds of national interest. Regimes that are based only on national security, like that in the US but also Germany and France—even with a very different culture in many ways—have not seen a lowering of levels of foreign direct investment over time, because they have introduced, modified or kept these regimes up to date. It is because, on the one hand, the stable environment that they provide and that the UK will definitely provide for foreign investors, is far more attractive than any uptick in cost from having to get up to speed on a new regime; also, they are able to retain these global perceptions of openness to foreign investment and ease of doing business because of the way in which the rules are applied. As long as the rules are applied consistently, and with clear reasons behind their use, and applied consistently and transparently over time, it should be okay.

The Bill provides for a lot of regulatory guidance, which needs to come forward in a clear and very easily comprehensible and understandable manner. As long as that happens, it should be okay. Global Britain should still be the proponent of liberal economic values that it always will be, while also being able to demonstrate to itself and to its allies that it is able to protect itself from this type of investment.

Going forward, Britain's relationship with many of its Five Eyes allies is going to depend on having a comprehensive regime of this nature that is used well. Under FIRRMA, under US law, for example, the UK is an exempt foreign investor in certain categories—one of three with Canada and Australia. It has been stated that for that to continue—it is going to be reviewed—it needs to have a regime to protect itself. We can talk about this later, but part of that is about the potential concern about not just the ability to share intelligence on these issues, but about acquisition laundering, export controls and all these issues that tumble on behind that can affect investment, trade and intelligence-sharing relationships over time. That is important.

The research evidence shows that foreign investment is not deterred unless there is a problem in how this is applied. There has been politicisation of cases; demonstrated proportionality of response is also extremely important. There are many cases in which a threat to national security can be mitigated by agreements and undertakings without needing to block a deal. When you look at the modern history of foreign direct investment intervention across Europe and the US—even if you look at Russia and China and how they behave—the preference is, where possible, to mitigate national security concerns through comprehensive agreements, and that can be done in a host of ways. It can be that you have a board of directors that is only UK nationals, or that you require divestment of a certain black box technology company to another UK company or a friendly allied country. Whatever it may be, historically, there has been a preference for that type of action to be taken. Vetoes of cases are actually quite rare since world war one, when we first really saw this type of issue pop up.

The concern is if we see the UK blocking deals where it could mitigate because a deal has become a political hockey puck. In today's world, where this is something that is constantly discussed in the *Financial Times* and *The New York Times,* whereas it was not 15 years ago, any case has the potential to be discussed widely in the political debate. The question is how it is treated by Government and how other countries perceive that treatment. I know that I have used US examples quite a bit, but if you look at US-China investment, China still invests a lot in the US, even though it complains every time a deal is blocked or mitigated. The reason behind that is because this is a sovereign right under customary international law, and China does the same thing when it has the same concerns. It is only if a case becomes truly politicised that there is an issue.

To give you an example, in 2005 in the US, the case of Dubai Ports World and P&O, which was a takeover of a UK company, became overly politicised in the US system. It is one of the only real examples where it has happened, and that was because there were a few US lawmakers who had a completely different view of the risk and relationship of the US vis-à-vis the United Arab Emirates than the Department of State or the Department of Defence. That is quite rare but what ended up happening was US lawmakers seeking to block a deal when most reasoned professionals in the industry and in various Government Departments thought that any risk could be mitigated simply in a host of other ways.

In the case of overuse, overbalancing, misuse, politicisation, whatever you want to call this tool of economic statecraft, there was a momentary blip in relations between the US and the UAE. There was a momentary stalling of trade talks, change in the currency basket and some uncomfortable months, but the relationship was strong enough to survive and it usually is. This is not really an aspect of going to war. I think the key is proportionality in response, how it is applied, and it is about consistency and transparency. The Bill is well written in many ways, but how it is used can go any number of ways, so it is about how the UK uses it going forward.

The Chair: Thank you, Dr Lenihan. There are lots of Members wanting to speak and we have limited time, so I will try to get through some quickly. I will call Stephen Flynn, Mark Garnier, then Stephen Kinnock.

Stephen Flynn (Aberdeen South) (SNP): Thank you for your comprehensive and helpful answers, Dr Lenihan. I would like to divert back to some of the comments that were made about the Bill on Second Reading, particularly relating to definitions, or a lack thereof, in relation to national security. I would welcome your thoughts as to whether the Bill should or should not have a definition.

My second question relates to the scope of the Bill, which you mentioned earlier. In terms of the consultation going on, 17 sectors have been identified. The glaring omission seems to be social media, but I would appreciate your view on whether artificial intelligence would cover off social media to a level that you would be comfortable with.

Dr Lenihan: Those are both really good questions that I hoped would be asked. If national security is that which seeks to maintain the survival of the state and preserve its autonomy of action within the international system, unfortunately that means that you cannot necessarily define national security in law without binding yourself in an inflexible way. What we have seen is that most foreign direct investment regimes of this nature all refer to national security. I do not know of a single one that actually defines it or limits itself to a particular definition. I could be recalling incorrectly but I have looked at over 18 of them and I have never seen a particular definition.

What you do see in regulations is guidance as to how national security risk might be assessed or examples of what could be considered a threat to national security. US guidance is helpful on this, in terms of how they put their regulations together. Some have argued that it is too comprehensive—it is a lot to read and provides the lawyers with a lot to do—but it is useful and has meant that the process of knowing when you might be triggering concerns is easy to navigate. I really do not think that the UK wants to define it in the Bill.

There was a US Government Accountability Office report in 2008 examining the foreign direct investment restrictions in 11 countries at that time. Each was determined to have its own concept of national security but none of them actually defined it. In 2016 the OECD did a similar report after a new resurgence of changes in laws, and it looked at 17 countries including Lithuania, Korea, Mexico and Japan, and they came to the same conclusion. The OECD has quite good guidance in general on this and they have not recommended that their countries define national security risk, but they have recommended regulations to help increase transparency around what could be considered a risk.

Regarding the sectors for mandatory notification, I think that is a very good question and one that it is difficult to grapple with in many ways, because the threat is emerging and changing at the very same time that technology is emerging, changing and interacting with our society in various ways. Various countries have been trying to deal with this. In the US, a final rule was just put out in relation to non-controlling investments and situations where you have certain mandatory notifications. A pilot programme was initiated in 2018 to try to define—as your consultation will, in many ways—the proper sectors using North American industry classification system codes, instead of standard industrial classification codes as the UK regulation does.

Whatever codes you use, though, the US found that they had an incredibly high volume of mandatory notifications and were not necessarily getting to the issue that they wanted to. They have changed that under the final rule, and now mandatory notifications in that classification are going to be defined *[Inaudible.]* and would come under certain US export control regimes. The idea behind that is that the US is doing a review of export control regimes, which will try to get to what foundational technologies might be of concern. I think that applies to your question about social media.

Social media is of concern because of the data, and data retention, involved in most social media. As I understand it, the sectors in the Bill will be kept under constant review and can be changed and updated as needed. That is important, and it might be worth doing a pilot programme.

The Chair: Dr Lenihan, I was trying to squeeze two more questions in, but I think it will probably be just one.

Q43 Mark Garnier (Wyre Forest) (Con): Thank you, Sir Graham. Dr Lenihan, my questions refer back to points you made in response to the first batch of questions. You spoke of the review regime not being quite up to full standard. It is an interesting dichotomy that the Bill sets up a new review regime in BEIS, but there is an export control unit in the Department for International Trade that already looks at arms control, as well as intellectually sensitive exports. I would be interested to hear your comments about how those two play together.

Secondly, it is worth bearing in mind that the Minister, Lord Grimstone, sits in both the DIT and BEIS. He is responsible for investment promotion. We are talking about more acquisitive types of investment, but do you see a potential conflict of interest between the ambitions of the Government to secure more investment into the UK and potentially having the wrong kind of investment?

The Chair: Sorry, Mark, but we have about 90 seconds for that to be answered. Please have a go, Dr Lenihan.

Dr Lenihan: I would suggest that the investment security unit and the unit that will handle the processing of this regime remain in BEIS. That is fine; however, it would be useful to set up in the Bill some sort of multi-departmental review body that contributes regularly, and that has staff in those Departments who monitor the risks in relation to this concern. As you say, the Department for International Trade will be able to monitor, find and catch risk that others—such as the Foreign, Commonwealth and Development Office, GCHQ and its new cyber unit—cannot.

It would seem very strange to not have a feed-in from intelligence agencies and the Ministry of Defence on a regular basis. If you set that up in an institution that is clear, at least to the outside world, about its composition and makeup, as opposed to having ad hoc feed-in over time, it would help with the perception of openness from the outside. It would also help to counter any claims of an individual or place being politicised or used for some other purpose by a particular Minister, because then they could give a balanced opinion for the Secretary of State in charge to make a final decision.

The Chair: Thank you very much, Dr Lenihan. That brings us to the end of the time allotted to the Committee for asking you questions. We are grateful to you for your time. Where members of the Committee wanted to ask questions and were not able to, I will try to give them a bit of priority on the next panel—or in another, if that is helpful.

Examination of Witness

Michael Leiter gave evidence.

2.45 pm

The Chair: We come to our fourth panel of witnesses. We will hear oral evidence from Skadden, Arps, Slate, Meagher and Flom LLP and Affiliates. For this panel we have until 3.30 pm. Mr Leiter, I welcome you, and ask you to introduce yourself for the record.

Michael Leiter: Good afternoon. My name is Michael Leiter, and I head the national security and Committee on Foreign Investment in the United States practice at Skadden Arps. It is a pleasure to be with you this afternoon.

Q44 Chi Onwurah: Thank you, Mr Leiter, for joining us and sharing your extensive expertise with the Committee. I wanted to look at strategic and critical industry. There are a series of cases where nascent or strategically important industries might become critical to national security in the future, but they are important to industrial and economic strategy now. For example, it was not clear that there was a direct national security threat from Deep Mind's artificial intelligence algorithms in 2014, but it is clear that the company was important for the UK then, and it is clear that artificial intelligence is important for national security now. That is reflected in the Bill. Based on other countries, how do you think the Bill can capture these forward-looking public interest or industrial strategy concerns within national security grounds for acting?

Michael Leiter: Thank you for the question; it is quite a good one. It is one that the United States has struggled with, as have other countries and their regimes. We suggest a couple of approaches. First, one piece that I think the Bill does quite well—although there is a countervailing concern that has to be addressed—is not having a de minimis threshold, in terms of dollars. The Bill is quite strong in that regard, because as you note in your question, just because someone acquires a start-up company for a relatively modest amount—a few million pounds—it does not mean that that company and that technology does not have, or will not have, very significant national security implications.

The flipside of that is, of course, that without the de minimis threshold, it becomes a far more difficult regime to manage. The volume can be much higher. It can potentially poison venture capital innovation. This is best balanced by not having a threshold for dollars, as you do with the no de minimis threshold, but then making sure that regulators have the ability to review these matters extremely quickly. The pace of investment in emerging technologies requires a very short timeframe. It is not like a large public company transaction, which has extended timelines. As long as one implements a very rapid review process and has the officials in Government to keep up with that potential backlog, I think those two interests can be effectively balanced.

Q45 Chi Onwurah: To follow up on your point about notifications, the Government impact assessment for the Bill suggests that up to 1,830 notifications might come in each year under this new regime. I am concerned that they look at the impact on the acquirer, and they do not capture the fact that almost every start-up seeks capital investment at some point. What impact do you foresee on the overall UK investment climate, and what might FIRRMA and CFIUS changes lead us to expect in our case?

Michael Leiter: This is very important. I was rather taken aback by two things about the Bill. The first is the projection of over 1,000 matters, going from the very, very few that the UK has traditionally had; this is an explosive increase in matters. I am concerned that no Government are ready for that rate of change. Even in CFIUS under FIRRMA, although there is not an increase in the overall number of long-form notices, in the short-form declaration process, there was an increase. That was relatively modest, an increase of about one third, so the US now reviews approximately 240 full cases, and about another 100 short-form.

When you talk about going from a few dozen to 1,000, you have to be very sure that you have both the resources and the expertise to process that. I would be concerned by that. Another case where your Bill goes much farther than anything I have seen, and certainly much farther than anything in the United States, is in encompassing not just acquisition and investment in businesses but acquisition and investment in supplies, goods, trade secrets, databases, source code and algorithms, so it is tangible and intangible objects, rather than businesses. That scale is very difficult to predict, and if one is more in the mood for incremental change, so as to see how a Government can handle change, including those elements poses some real risk for management.

Q46 Nadhim Zahawi: Thank you, Mr Leiter. That is really good feedback. Building on the point made by my colleague the shadow Minister, the CFIUS regime in the US obviously operates successfully, in the sense that the US remains an incredibly attractive place for inward investment. How have the US regulators balanced those two things? Does the Bill as drafted provide us with a similar opportunity to strike that balance?

Michael Leiter: I am honoured to have worked with the UK Government for 20-plus years on security issues, and over the past 10 years on economic issues. I certainly think you have the potential to strike that balance. In the US, traditionally, the CFIUS structure was a balance between the security agencies, which tended to want to restrict investment, and the economic and commerce agencies, which tended to want to encourage that investment. Certainly, in the case of China, we have seen massive decline in direct investment because of both Chinese controls and US controls: a tenfold decrease from 2016 to 2018. But as you said, the scale and strength of the US economy mean that global investors look to the United States no matter what.

I do not mean to make less of the UK in any way but, from a UK perspective, one has to be a bit more careful, because you simply do not have the scale that inevitably will attract investment. The US could be a rather poor place to invest, with lots of regulation, but people would still come because of the scale of the market. You don't have quite that luxury. That is not to say that the UK has not for generations been an incredibly attractive magnet for investment, but whereas the US can err on the side of security, from my perspective, admittedly an American one, the UK might want to be a bit more careful about restrictive measures, because the size of the market is not in and of itself so inherently attractive that companies and investors must be in it. We have a bit of an advantage over you on this one.

Q47 Peter Grant (Glenrothes) (SNP): Good afternoon. I do not know whether your saw much of the previous witness's evidence, but she commented on how countries such as the United States have a limited number of excluded or exempt countries—including the United Kingdom—that are not covered by their equivalent legislation. What are your thoughts on how the Bill does not have any provision to exempt entire countries from its scope?

Michael Leiter: I was able to see part of Dr Lenihan's excellent testimony, which was quite informative and good. First, to clarify, although the US does make distinctions for exempted countries—obviously those are the UK, Australia and Canada right now—that exemption is extremely narrow. It limits those countries only on mandatory filings, and only if investors from those countries fulfil a fairly rigorous set of requirements. So, although Canadian, UK and Australian investors were quite excited before CFIUS reform, when the regulations about excepted investors were promulgated, that has had a minimal effect on those countries. It is not a significant advantage. Those countries are still subject to CFIUS review in the vast majority of investments they make. Now, that gives only half the story, because clearly investments from those nations go through a much less rigorous review, and come out with much better results than those from countries where the US has a more strained security relationship.

On what I see in the Bill, I would say a couple of pieces about the excepted possibility. First, as I read the Bill right now, it covers investments from other UK investors—not even simply those outside the UK. If my reading is correct on that front, I have to say that is probably not wise. We have already talked about the significant increase you could have, based to some extent on mandatory transactions as well as some other factors, and I think trying to take a slightly smaller bite of the apple and not including current UK businesses in the scheme would be well advised.

To the extent one has open trade and security relationships with certain countries, lowering the bar for review to exempt them, or including things such as dollar limits and getting rid of the de minimis exemption, might well make sense. That is another way of making sure that the Secretary of State can focus on those areas you think are the most sensitive from a security perspective. Whether we like to do so or not, that can be aligned to some extent with the country of origin of the investor. It is not always perfect—one must often look below that, especially when dealing with limited partners and private equity—but it is a relatively easy way to reduce the load you may experience if all these measures were implemented.

Q48 Nickie Aiken (Cities of London and Westminster) (Con): There are 17 sectors included in the Bill, but are any sectors missing? Is there scope for future-proofing?

Michael Leiter: Right now, it is a very robust list. In fact, I would probably err on the side of going in the other direction. I think this is a good list of 17, but what is critical is that these sectors gain further definition about what this actually means. Let me give you a quick example: artificial intelligence. I invite you to go online and try to find more than 10 companies in the world right now who are doing well and do not advertise their use of artificial intelligence in one way or another. It is one of the most commonly used marketing terms there is: artificial intelligence and machine learning, all to serve you in your area of work. If one interprets artificial intelligence as encompassing all those businesses, there will be a flood of reviews. Now, if one focuses on those companies not using artificial intelligence but actually developing artificial intelligence, I think the definition of the mandatory sector will make much more sense. That is an area where I think the US is still finding its way. As Dr Lenihan noted, the US began with a set of listed sectors where transactions were more likely to be mandatory. They eliminated that and now focus purely on export controls, but again, it is not that a company uses export control technology; it is that it produces export control technology.

That may be too narrow for your liking, but if one mapped out your 17 sectors as currently described to their widest description, I think there would be very little left in the UK economy, except for some very basic manufacturing and some other services that would not be encompassed. This is a very broad list and, again, I think it will take some time to tune those definitions so they are not overly encompassing. Again, if you look at data infrastructure, communications, transportation —at their extreme, that is quite a broad set of industry descriptions.

Q49 Sam Tarry (Ilford South) (Lab): Just thinking and reflecting on a few of your comments, Mr Leiter, if we are given the timescale that you have had at CFIUS—it has a long history, it has been here a long time and you have brought in a new and updated regime to meet the threats that the US Government see are coming towards us—how could we translate that to our context as we put together this regime here? Are there any particular lessons that we could use? Are there new threats that have been captured by the new regime that you now have in place?

Michael Leiter: Thank you for your question. I will do my best to provide some advice. I do so with some hesitation, because I readily accept from my experience working with the US and the UK that although we are related, we have two very different systems. The scale of our Governments and the scale of our private sectors are different, so one should always be very careful of trying to learn lessons from any other single country.

First, I would try to take this incrementally. This is a very big step and in trying to predict second-order and third-order effects of this—both the security effects, which may be positive, and the economic effects, which may not be as positive—I would tread carefully. I would start narrowly, then open up the aperture as necessary, rather than opening up quite wide and then narrowing it down.

Secondly, I think it will take some time, and not only to develop the administrative capabilities to handle this volume within the Government. I think you would have a significant amount of learning to do within your private Bar as to how this works, but also how to manage those voluntary filings. You are talking about including voluntary notifications across the economy, which I think is quite a sensible approach, but that requires a degree of collaboration between the UK security sector and the Secretary of State and the UK private legal Bar and commercial sector to understand where those national security threats and risks may lie. This is something that has developed in the United States over the past 20 years, but does not, in my view, yet exist fully in the UK.

Next, I would say that it is very important to consider how this should be applied for limited partners in private equity. Private equity plays a massive role both in UK and US investment and having clear rules about limited partners and the rights that may or may not implicate non-British ownership in those private equity funds is a very important step to take and one that should be clarified up front. It should not be approached without further clarification.

Lastly, I think it is important to build into the scheme the ability to evolve as technology evolves. I heard some of the questions about social media during the previous panel and it would have been very difficult to understand the sensitivities that are implicated by social media 10 years ago, or perhaps even five years ago. The ability for the review and notification to evolve with changing technology, access to data and new national security threats is critically important. The regime should be a living one that will evolve with those changed political or technological circumstances, not one that keeps still.

Q50 Sam Tarry: Following on from that, given the scale and breadth of the challenge you have outlined, covering so many areas, including private equity, how do you think we would best resource and staff this arrangement? Clearly this will be a potentially large undertaking for the Department as it stands at the moment.

Michael Leiter: Having worked with some of them, I think you have some outstanding individuals in some of the relevant Departments who can look at this matter. I believe that they will have to increase their interaction with the security elements of Her Majesty's Government in a way that does not perhaps yet fully exist. The departments and agencies that I worked with while I was in the US Government were generally fairly separate from these sorts of investment review, and it will be necessary for training among those agencies to ensure that there is an understanding of the nature of acquisitions and investments in the private sectors in a way that security agencies do not yet fully understand it. Teaching the economic agencies about those security concerns will also be necessary. I think that the Government will need an initiative to make sure that there is a degree of integration across Her Majesty's Government based on an understanding of those cross-fertilisations, which will take some period to take hold.

Q51 Andrew Griffith (Arundel and South Downs) (Con): It is a pleasure to serve under your chairmanship, Sir Graham.

Thank you for joining us, Mr Leiter. It is invaluable to have a practitioner's perspective as we make legislation; that is something I would like us to do more often. I wanted to ask about your practitioner experience with respect to two things: first, the inclusion in the Bill of personal criminal sanctions and, secondly, its behavioural impact, from the point of view of attorneys and lawyers advising clients, on the likelihood of notification.

Michael Leiter: Let me answer that with two points. First, there is clearly an educational process when such a new regime comes into place for bankers, attorneys and business people. This regime will take some time for them to understand as well, but I think that the UK, like the US—I have already drawn some distinctions about the risk of reducing investment in both countries—remains overall one of the most attractive places to invest in the world. One of the reasons it is so attractive is that it has a strong rule of law and courts system, and clear legislation. In that regard, those who would come and invest in the UK very much understand the need to comply with these regulations, and criminal and civil penalties.

What we have seen in the United States is an appreciation, even if there was some initial shock at the scope of the review and what might be considered a national security concern, and a very robust understanding that we at the Bar and our clients have developed about the importance of these reviews and compliance with the legal regime that applies. I do not see any likelihood of, or reason for, the same not taking hold in the UK. I find that my clients are quite appreciative of the counsel we give them, whether it is related to the US or a UK foreign investment. Overall, I think that the concern tends be less about personal criminal liability, although such concern undoubtedly inspires some, and more about the ability to continue to have good, strong, open relations with regulators in the country in which business is being done. That is critical.

The second piece I would commend you on, which is much better than the US system, is that the Bill provides for a very full and complete review by your courts. That is quite positive, especially with the change that will have to be implemented by the Government. The fact that there is an ability to turn to the courts for review is central and important. As you may know, that is not nearly equivalent in the United States. The ability to pursue remedies in the courts in the context of CFIUS is actually quite narrow. On behalf of my clients, and for improvement of the system, I am quite jealous of your approach on this front.

Q52 Stephen Flynn: Thank you for your comprehensive answers, Mr Leiter. I am afraid that I have crossed out many of the questions that I had because your answers have been so comprehensive. To go back a couple of steps, you have referenced the structure and understanding of the regulations, and the challenges posed by that, as well as the understandable challenges posed by the creation of a new body to oversee the call-in process. That, understandably, will take time to implement. Do you think that lag and uncertainty might put off investors? On a similar line, in terms of the timeframe for call-in, there is the five-year retrospective, the six months for the Secretary of State to act, and the potential for up to 75 days or more to act. Is any of that likely to put off investors?

Michael Leiter: I will take those in reverse order. You are absolutely right: the timing is often central to much of what goes on in the world of mergers and acquisitions. With respect to the effective five-year look-back with six months of notification, that is not dissimilar to what we have in the United States. It serves a very useful purpose in that it certainly incentivises parties to file voluntarily.

To the extent that one includes a voluntary notification regime, I think that it is very important to have some period of look-back. I do not have a strong view whether that should be four or five years, but I do think that look-back is important in a voluntary regime. Of course, in CFIUS, there is no statute of limitations at all, but in reality, we rarely see CFIUS going back more than one year, at most two or three. Again, I think that if everything were mandatory, this would not be required, because to the extent that one has a voluntary regime, it is perfectly reasonable to give the Government an opportunity to look back. Doing so also provides an important incentive for parties, because they will often calculate the likelihood of the Government coming and knocking on their door one or two years down the line. I think that a general approach makes sense.

With respect to the specific timeline for the reviews, your Bill mirrors not perfectly, but closely, the CFIUS approach. In most cases, that timeline works relatively well, but there are a few exceptions. First, in public company mergers and acquisitions, this is no problem. The period between signing and closing tends to be quite long, so the idea of 75 days is not problematic. Similarly, whenever you have a matter where there is a competition review, which of course encompasses many things—on our side, Antitrust and Hart-Scott-Rodino, and in the UK and EU there are separate regimes—that 75 day-period seems to fit relatively well, provides sufficient time for the Government do their review, and will not be problematic.

The place where I think this is more problematic—I apologise that I cannot recall the Member who asked the question—is in smaller-scale, early-stage venture investments. That is where deals can go signed to close within hours or days, and having that longer period could be quite disruptive. In that sense, to the extent that one is concerned with early-stage technology investment, these timelines can be problematic, and finding a window to get through that quickly is quite important.

Finally, with respect to the timing of implementation and the time that it will take to get up to speed, I think it is important to have this effectively phased. I know I have said this several times, but I think this is a rather seismic shift in the UK's approach to review of investment. I am not saying it is a bad shift. I think it is a shift that is consistent with the United States and other allies in Europe, and Australia. I think it is going in the right direction, but it is very significant, so having some opportunity to make sure that both the private sector and the public sector are ready for that and understand the rules—that the sectors are defined in a clear way and that parties understand, especially in the realm of having criminal penalties—I think it is particularly important to do that.

I think there are probably ways, to the extent you are worried about a risk during that interim period that things are not being reviewed, of addressing that as well, with the look-back provision, or initially implementing things in a narrower or separate sense, but I would be a bit careful about not having some transition period, which allows, again, both the public and private sectors to adjust to this very significant change.

Q53 Stephen Flynn: Obviously, the consultation in relation to the 17 sectors, which was mentioned earlier by a colleague, is going to run beyond the end of the Bill—perhaps, I imagine, of its being implemented. The Government may well just get it through the House, but were that to happen the consultation would still be ongoing, so, again, I am sorry to try to pin you down on this, but do you think that would create a level of uncertainty that investors simply would not be comfortable with, and that they might well look elsewhere unless the Government were clear about having a system in place that makes things more flexible for business?

I am sorry to flip back again, but on smaller-scale early-stage ventures, we said this could be an issue, and again, I am sorry to pin you down: could it, or will it, be an issue? Where would you lean in that regard? Will we find that investors seek to go elsewhere with this a little bit more, where the timing is a little easier?

Michael Leiter: I think it will be an issue unless you are confident that small-scale, early-stage investors can have their transactions quickly reviewed within roughly 30 to 45 days. If it is longer than that, that will make the investment climate, I think, worse than other competing markets. I think that could have an impact.

On your first point, let's face it, business always likes predictability, so you always want certainty, but deal makers have to understand risk and understand some uncertainty. That is inherent. I will say, it is not that the US has done this remotely perfectly. The US announced almost two years ago now that it was going to further define foundational and emerging technology that would then be subject to different levels of review under CFIUS. Here we are, almost two years later, and we still do not have that. The fact is that there has been uncertainty, and there will be uncertainty on your side as well. Having those definitions clarified as quickly as possible is good.

Do I think that a lack of clarity for three, four or five months about these sectors will suddenly stop investment in the UK? No. I don't want to exaggerate it to that degree. You can try to pin me down, but the fact is this is all a matter of balancing, and there is no clear answer about when people will stop or start investing. More clarity is better. The faster there is clarity, the better, and to some extent, a lack of clarity will push people to look at other markets.

Q54 Stephen Kinnock (Aberavon) (Lab): It is a pleasure to serve under your chairmanship, Sir Graham, and thank you very much, Mr Leiter, for your insightful evidence. I was wondering about the acquirer definitions, which are an important part of the equation, and the extent to which the legal structure and ownership base of the acquirer should play a role and, perhaps, be more clearly defined in the Bill, in terms, also, of what the triggers are for the screening process. If the acquirer is a state-owned enterprise or a state-backed investment vehicle, should that trigger a, for want of a better word, tougher or more robust screening process? If so, what might that look like in practice, and do other regimes contain that differentiation between a private sector acquirer and a state-backed acquirer?

Michael Leiter: Thank you for the question. The answer is that many regimes do draw such a distinction, which is generally a good thing, but there is an exception to that as well. This is important on two points, one of which I have already raised so I will not belabour. Understanding the ownership structure of private equity to understand how the Bill will or will not handle limited partners who are managed by a general partner at a fund is very important. That is a significant amount of investment, and clarity on that point is critical.

In the United States, for example, foreign limited partners in US private equity are fundamentally, overall, not considered for CFIUS. For foreign private equity investing in the United States, foreign limited partners are considered. Again, that is broad brush, but that is fundamentally how it works. With respect to sovereign wealth funds or state-controlled investments, there is a perfectly good argument that yes, the standard of review might be a bit more rigorous. In the United States, the way that works is that if a foreign Government-controlled entity invests in what is known as a TID business—one that that deals with critical technology, critical infrastructure or sensitive data—in the United States, and if they own more than 25% equity, that is a mandatory filing. So, it is increasing the likelihood of a mandatory filing if you are controlled by a partner.

Using such a standard makes sense. Right now, I do not believe the Bill provides many opportunities for that. You are already saying that, in the 17 sectors, all will be mandatory and there is no de minimis threshold. From that perspective, whether you are a sovereign wealth fund or not, it will be mandatory in a large scale of matters. You could of course say, with a dollar threshold such as you have now, that in the voluntary sector, if it was a state-sponsored entity, that would also be mandatory. I think there is some sense to that, but I would move slowly on that because, as I have noted several times, you are going to have a relatively high number of mandatory filings in the first place.

There is a second important piece to this, though, about whether you actually want to change it for Government-controlled entities. That is, especially in the case of China, but other countries as well, the distinction between state controlled and not state controlled is becoming less and less. Again, in some western democracies, it is quite clear whether it is a state-controlled entity, but to the extent a foreign Government can influence a private sector actor, that distinction starts to fade away, at least partially. Under your regime, it is not clear to me, other than expanding some voluntary into mandatory, how that will apply, and I think, to some extent, the distinction is losing some of its fineness.

Q55 Stephen Kinnock: I have a small follow-up question. The points that you have been making about private equity are very interesting. Large swathes of our social care system in this country, particularly residential care homes, are owned by private equity companies. Do you think it would have a material impact on the assessment of a private equity company if it was looking to invest in the social care sector, which one could argue is critical national infrastructure?

Michael Leiter: That raises two excellent points. First, yes, I think private equity is quite methodical about thinking of those restrictions. Whenever I deal with private equity in the Unites States, whether it is US private equity, foreign private equity or sovereign wealth funds, there is always a consideration of the way in which the business in which they are investing may be subject to a national security review and whether or not they will, even if approved, lose access to critical information, technology or other management control of the business in a way that would make it a less attractive option. From a US Government perspective, I think that is entirely appropriate; it is the entire purpose of the national security reviews.

It could affect the choices of private equity in the UK, but one still has to identify what the national security risk would be—and not just what the national security risk might be, but the extent to which, if the investment was allowed, the Government could still put in place restrictions that would eliminate or mitigate that national security risk. That leads me to make two very quick points.

First, there has been much commentary about defining what national security means. I would not welcome to go down that path; frankly, I think it is a bit of a fool's errand. The Government will define national security as they may. Certainly, they should not overreach in extreme ways, but this is not one that I think legislative language is well tuned to trying to capture. That is not to say that it should not be limited in practice, but trying to capture it in legislative language is, I think, exceedingly hard. Again, it changes over time, depending on technology, access to data and other factors. One can imagine certain things that, before covid, we never would have considered to be issues of national security, but that are today. Capturing language for that is quite challenging.

The second piece is making sure that you have a good regime. We have been talking so much about screening, punishment and what falls into the bucket of review. There has been much less discussion here, and there is much less discussion in the law, about what mitigation and rules and enforcement there will be. If you permit a foreign investor to invest in one of these sectors and you put in place certain protections to protect British national security, how will you actually make sure that that occurs? It is wonderful to have these rules, but unless you actually have the regime and follow these things and ensure that there is enforcement and monitoring of them, you will have spent an enormous amount of time and money but actually not protected national security, so I think we should not give short shrift—*[Inaudible]*—deal is closed and approved but still being monitored by the Government for the very national security risk we are trying to protect against.

The Chair: We have to end this session at half-past 3, so I think that this will be the last question and it will come from Simon Baynes.

Simon Baynes: Actually, Mr Kinnock has asked my question, Sir Graham.

The Chair: In that case, the last question will come from Matt Western.

Q56 Matt Western: Thank you, Sir Graham. Mr Leiter, I would like clarification on the point about disguised takeovers, and perhaps you can use CFIUS as an example. What happens if a benign country or an organisation in a benign country, such as Canada or wherever, takes over a business and then that gets sold on to a state actor or a non-obviously state actor? How does CFIUS respond to that, and do you think that this Bill covers it?

Michael Leiter: I think your Bill does cover it. CFIUS would cover it in two ways. First, to the extent that a non-benign actor was behind the first transaction, CFIUS looks at the ultimate parent and whether it has been structured to evade review, so I think there is robust authority there. Secondly, the follow-on transaction itself would of course also be subject to CFIUS review, so I think you could catch it in the first instance or the second instance.

I think your Bill covers that. I will say also that I think the Bill is quite expansive and potentially problematically so. The US regime looks to see if there is a US business that is being acquired or invested in. That is a broad definition, but it still requires, generally, some physical presence, some people or the like. Your Bill does not seem to contemplate that, and specifically it says, "If the business simply provides supplies and goods to the UK or from the UK". That is a very broad definition. It fundamentally means that if someone in London is buying something from a US business and it sends that to London—well, I read that as being covered by the Bill. That would actually be more expansive than CFIUS. It might, in that sense, give you greater national security protection, but I think it also may implicate a far more significant scale of transactions.

The Chair: Thank you very much, Mr Leiter. We are grateful to you for giving of your time so generously to assist the Committee.

Examination of Witness

David Petrie gave evidence.

3.29 pm

The Chair: We now move to the next session. David Petrie is from the Institute of Chartered Accountants in England and Wales. Mr Petrie, would you be so kind as to enough introduce yourself for the record?

David Petrie: Good afternoon, Sir Graham, and thank you very much indeed for inviting me to give evidence to the Committee. My name is David Petrie, and I am head of corporate finance at the Institute of Chartered Accountants in England and Wales. My background is in corporate finance and mergers and acquisitions, for 10 years or so now in my current role at the ICAEW and prior to that with PwC. My experience includes advising on transactions, principally in the mid-markets, including private equity buy-outs, company sales and some infrastructure transactions. Prior to that I had a career in industry as well, so I have seen all sides of the fence on this, I suppose.

The Chair: Thank you very much. Before I move on to taking questions, I remind everybody that this session has to close by a quarter past four.

Q57 Chi Onwurah: Welcome, Mr Petrie, and thank you very much for placing your expertise at the disposal of the Committee. You have experience of mergers and acquisitions, and I am sure you will be aware that we have seen several transactions in this country—I will name GKN and Melrose, SoftBank and Arm, and indeed I will include the failed Pfizer-AstraZeneca case—where it appeared that the Government had no legal powers to secure jobs, pensions, research and development and key UK industries, relying instead on behind-the-scenes soft power. That created uncertainty and lack of clarity for investors. Do you think that is a problem for both Government and investors, and how do you think we could effectively tackle that gap?

David Petrie: The Government have been very clear that the purpose of this legislation is to focus on protection of national security. The guidance notes they have issued, which accompany the Bill and are intended for market participants, are very clear on that aspect. I would suggest that probably all the factors you listed in your question extend beyond a simple matter of national security—if national security can be a simple matter; no doubt that this Committee has heard this afternoon about the difficulties associated with defining national security. Many of the factors that you set out there, important elements though they are to all stakeholders in a company, are not necessarily matters of national security.

I would also say that that for some of the companies that you mentioned there, while certain of their activities might well be included within the scope of this new Bill, it would be very difficult in certain instances to suggest that they had a direct impact on our national security. Of course, that would be up to the new investment security unit to determine, based on a full representation of the facts. If that unit was at all concerned, a procedure is set out in the Bill whereby it would be able to call for as much evidence as it felt was necessary in order to be able to reach a balanced determination on whether investment by an overseas entity did indeed constitute a real threat to our national security. I think that is the point here.

Q58 Chi Onwurah: Thank you for your response. If we look at GKN-Melrose and, indeed, even SoftBank-Arm, we could consider that they had national security implications. I suppose the point is that there are essential industries that are directly critical for our economy, but that at first may not seem directly critical for national security because they are evolving technologies, as in the case of Arm and the ongoing takeover by Nvidia, or because they are indirectly critical as suppliers to downstream industries that support national security. Indeed, in the response to the Government's consultation for this Bill, an example is given of the undermining of the functioning of an airport by a software manufacturer, which would be within the transport sector but would not necessarily immediately appear to be directly concerned with national security. Economic security and national security end up being linked. Do you think that should be reflected in the Bill, and how do you think it can be reflected?

David Petrie: I have read the impact assessment, which included that example. It is a difficult situation, as described in the example. In accordance with the way that this new legislation is drafted and the number and extent of the sectors that are regarded as mandatory—the sectors in scope such that their operating activities would require a notification of the unit—the example set out in the impact statement would indeed require screening by the investment security unit. The Government would likely have the opportunity to review a potential acquisition in that software company.

I was struck by that example, in that it suggested that service had failed, or a malign actor had decided not to provide the necessary services to the airport. I think a broader question here is what might happen in reality. Those services would be procured through a commercial contract, which in turn would, presumably, be backed by insurance. If it were an absolutely critical service, I would expect that the airport would have a back-up system, whether power supplies or a parallel running system, as they do for air traffic control. There are commercial protections for the actual operating activities of critical infrastructure, which should work. It is difficult to protect against the actions of malign actors, but critical infrastructure already has systems and processes, and invests heavily in capital equipment, to ensure that there is not an interruption of supply. The question would be the extent to which ownership of that asset physically gave the owners of the shares the ability to get in and interrupt supply. That almost implies mechanical breakdown or some deliberate and malign disconnection. Again, companies have cyber-security systems in place to ensure that critical infrastructure does not fail.

The point you made was about whether suppliers of that sort of service to our critical infrastructure and their ownership should be subject to review. As the Bill is set out and as the sectors in scope are drafted—of course, the Government will consult over the next month or so on those definitions and whether they should be adjusted or whether they are as wide-reaching as they should be—a business like that would be captured. The investment security unit and, presumably, the security services would have an opportunity to review whether or not to allow that to go ahead.

Q59 Nadhim Zahawi: Mr Petrie, you will understand better than most that businesses will want to ensure information is being treated sensitively in any transaction. I want to capture your view of the closed material procedure for judicial review under the Bill and what you think of it in terms of that sensitivity of information.

David Petrie: I think a quasi-judicial review is really important and a part of the process, and then, if necessary, there is judicial review. I think the question cuts back to how many times that is likely to happen. We have to step back a little bit and recognise that that would be a situation where the parties to the transaction are challenging the Secretary of State's decision as to whether or not this is in the interests of national security.

I would assume that if the sellers are British companies, they will probably have received what they feel are adequate assurances that it is okay to sell to an overseas acquirer, but the Secretary of State takes a different view, presumably based on evidence provided by our national security services. Ultimately, if there is a compelling body of evidence to suggest that a transaction should be modified or adjusted or, in extremis, blocked, it would be quite an unreasonable group of shareholders to disagree with that if the if the Secretary of State was applying the test as set out in the Bill, and indeed in the guidance note, that intervention is to be limited only to matters where the national security of this country is at threat.

That is quite different from the national interest. It is tempting—or possible, rather—in this debate to get sucked into questions about what we should and should not be doing in this country. That is not what this is about. The Government have been very clear to the investment community, and to British business more generally, about the purpose of this legislation. That is why, although markets and investors recognise that it will take a certain amount of time and effort to comply with a mandatory regime—the Government have been very clear about their purpose in introducing that—the market is generally favourably disposed towards it. We can see that it is unfortunately necessary in these modern times.

Q60 Stephen Flynn: Thank you, Mr Petrie, for your answers so far. I just have a couple of straightforward points for you to address. We discussed the timeframe in earlier sessions, in relation to the five years of retrospectivity, the six-month call-in and the potential 75 days. Do you have any concerns about the impact that that might have on potential investors into the UK? On a similar note, in terms of the fact that there will potentially be in excess of 1,800 notifications annually, an entirely new body will have to be set up, possibly working across Departments and involving the security agencies. A lot of detail will need to be put behind that, and again, that will take time. Do you think any of that will cause any uncertainty among investors and perhaps lead them to look elsewhere?

David Petrie: Perhaps I could deal with the second part of your question first, if I may, on the potential number of notifications that the new legislation is going to necessitate. The first point I make about that is that this new investment security unit will need to be very well resourced. A thousand notifications a year is four a day; I am just testing it for reasonableness, as accountants are inclined to do. That is quite a lot of inquiries. I note from the paperwork that the budget allocated to the new unit is between £3.7 million and £10.4 million. I do not know and cannot comment yet as to whether that is likely to be adequate. What I can say is that the impact statement also suggests that of those 1,000 or so transactions which are going to be subject to mandatory notification, only 70 to 95—the numbers set out in the impact statement—are likely to be called in for further review by the Secretary of State, where a very detailed analysis of those businesses and the potential target is going to be necessary.

As, I hope, has been echoed by other witnesses, it is going to be extremely important that this new unit can engage in meaningful pre-consultation with market participants—with British companies, finance directors, and investors and their advisers—so that they can get a pretty clear steer at an early stage as to whether or not this is likely to be subject to further review. If the unit operates in a way where it can give unequivocal guidance to market participants at an early stage and is open to dialogue—I understand from discussions with the Minister that this is the way the unit is being asked to operate—that would be extremely helpful.

I would say that that is about process, certainly, but I think it is also about culture. It has to be a balance, which is well achieved by the Takeover Panel, for example, in this country. You do not tend to approach the Takeover Panel unless you are well-informed and have done your homework—"Don't bother us with stuff you ought to know" is the unwritten rule. But at the right time and place, I think it is important that there is an opportunity for market participants to be able to engage in a dialogue. The guideline where we put this "Don't bother us with stuff you ought to know" question is going to shift. At the moment, we really do not know a lot about the way the Government are going to look at certain transactions. We do know which sectors and operating activities are in scope, but, again, we are not quite sure at what stage it will be right to consult and try and get clear guidance. This process will evolve.

I note that the Bill includes provision for the new unit to issue an annual report as to the number of transactions called in and the sectors they are in. That will be extremely helpful for market participants. An issue here, I think, is potentially asymmetry of information. In order to resolve potential asymmetry of information amongst the investment and advisory community, it would be very helpful that the unit is well resourced and able to engage in meaningful pre-consultation, but, by way of a third recommendation, it would also be extremely useful if it was able to issue meaningful market guidance notes, similar to the notes that accompany the takeover code. That would again be extremely helpful so that we can understand. It would help the market to be better informed. If, for example, the unit is receiving a lot of notifications that are not correctly filled in or with important details as to ownership missing, then it would helpful to have guidance notes as to what we can do to make sure this process works with more certainty, speed, clarity and transparency—these are the things financial markets need to see—to help us with that, beyond what has already been issued, which is very helpful, I have to say. As the market evolves, that would be extremely helpful.

Q61 Mark Garnier: May I follow on from that question about the resources? There is talk about 1,800 companies coming forward and voluntarily disclosing that this transaction is going on, but I am just as interested in what happens with those companies that do not disclose this? I am not for a moment suggesting that there are a huge number of dishonest actors involved in the corporate finance market, but given the fact that the threshold was reduced to £1 million a year under the recent review, there are an awful lot of small businesses with turnover of about £1 million a year that are not very well resourced for their corporate governance functions and that could easily miss the requirement to disclose, should a transaction come through that is enticing for the shareholders, who are presumably offered the same as the directors. Are you confident that the Government have in place sufficient resources to be able to police the whole sector, to make sure that we are not missing out on a number of transactions that are going through? Even if we do, are we getting in there quick enough to make sure that the intellectual damage is not done by the time we have found out what is going on?

David Petrie: That is a very difficult question. We will find out—that is the answer to that. I think businesses working in sectors where there is a real threat to national security know that. They know that they are involved in weapons design or designing software that could have a dual use. In advising companies over the years, I have found that no one knows better than the company directors about the value of their assets and their business, both from a market perspective and to competitors or others seeking to gain access to their technology.

The Bill has been in discussion for some years now, and the advisory community is well aware of its existence and of the Government's desire to put this legislation on the statute book, so I do not think there will be many corporate finance advisers for whom the Bill emerging last week was a surprise. I am very sympathetic to the points made about small companies falling under the provisions of the Bill, but I hope that it will be possible for them to complete what, in the first instance, is a five-page questionnaire—when completed, it could run to 20 pages or more—at a relatively low cost.

To my earlier point, I hope they are able to engage in formal and meaningful dialogue with the unit at the earliest possible opportunity by saying, "This is what we do, and this is what we are worried about." They have to say, "We're concerned about this. These are the people from whom we are hoping to attract investment to take the business to the next stage. How do you feel about our business, and how do you feel about the people we are talking to? How does the Government feel about xyz corporation?" I think that kind of steer would help remove a great deal of uncertainty from the circumstances that you have set out.

Q62 Simon Baynes: Thank you, Mr Petrie, for a very interesting presentation. I want to look at two areas. One was touched on by the previous witness: the inclusion of not only businesses, but tangible and intangible assets. That is one issue. The second is the acquisition of material influence over qualifying entities' policy being another trigger point. I would have thought that these are more subjective—perhaps I am wrong—in terms of how you define them, whereas the other trigger points are obviously very clear cut. There are different levels of voting shares in the qualifying entity. I think the previous witness was somewhat surprised to see the tangible and intangible assets element of it and said that this goes further than other similar regimes in other countries. Can you comment first on whether you are surprised or whether you think it makes perfect sense? Secondly, is it easy to define the material influence and the assets, either intangible or tangible?

David Petrie: On the question of tangible assets, it really depends on what we are talking about. Again, it was trailed in the White Paper and the Green Paper that assets would also be within scope, so it is not going to be a surprise. It depends very much on the nature of those assets. In a relatively small country, the ability to acquire land or other buildings—strategic assets—immediately next to a sensitive military installation is, presumably, now included within scope because people who know about these things think it ought to be. I think the investment community will have a degree of sympathy there.

With intangible assets, that is a much more difficult question. It depends on the extent to which ownership of those assets is necessary in order for a malign actor to have the control or the information that they might need. It is possible to gain access to intellectual property through means other than ownership, so the question here is, how might those intangible assets be applied in ways that might prejudice our national security in some way? Again, that is something that the unit is going to have to assess on a case-by-case basis.

It makes sense to include assets that could be sold separately, without the sale of shares in a business. Companies often do that. They may well sell a parcel of patents, or parcel up a division and sell it on because it is no longer core to their operating activities. That is understandable. The investment community will understand that. In short, it is not a surprise, and we are going to have to find our way through this on a case-by-case basis.

Q63 Simon Baynes: Could you expand on one or two examples of such intangible assets? You have stated patents. Could you illustrate what you understand to be such assets?

David Petrie: That would be the most obvious example. There are things like industrial designs, blueprints or chemical processes that may not be subject to patents. It is typically those aspects of production and design that it is necessary to ensure would be in the scope of this kind of legislation.

Much of the discussion that has led to the publication of the Bill has been around the ownership of shares or of the business—as to whether that is actually the bit that malign actors might want to get hold of. That may not be what really interests them with the business. It may well be intellectual property or these other assets, which it is necessary to separately define. If they are able to get hold of those without buying the company, then it seems to follow that it makes sense to include that within the scope of this Bill.

Q64 Simon Baynes: But they would be quite difficult to police, would they not? How would you know—

David Petrie: Yes. I don't think anyone is suggesting that the job of this new investment security unit is going to be straightforward. In fact, we are absolutely not suggesting that. It is going to be absolutely essential for Government Departments to work together and, going back to my original point, for this unit to be extremely well resourced, to be able to respond quickly and appropriately to what is put before it.

Q65 Peter Grant: Good afternoon, Mr Petrie. There will be some entities that try to take over British businesses where the warning flags are flown immediately, because it is well known that either it is a foreign state, or a company controlled by a foreign state. Often, it is difficult or even impossible to know who the ultimate controlling party of a business is if they have arranged to have their ultimate ownership registered somewhere offshore, where that information is not made public. Does the Bill, as presently worded, provide enough protection against a hostile power trying to infiltrate the system by going through a secretive intermediary state? If it does not, what more should be done in the Bill to protect us against that scenario?

David Petrie: This is an issue that is well recognised by the investment and advisory community. I think that, as you say so rightly in your question, the warning flags, flares or whatever they might be will already be going off if this is a particularly sensitive military asset that is being considered for acquisition. I think that the unit will be able to look first at the nature of the asset, and it will be apparent very quickly as to whether this is a very sensitive issue. If the acquirer is not a British public limited company, a British private company or one invested in by private equity, if the ultimate ownership is structured in a way that is not conventional—many companies are held through offshore companies for entirely conventional, obvious and transparent reasons for the investment community—and if there is something strange about that ownership structure that makes it extremely difficult to trace the ultimate ownership, it feels to me as though that would be one of the 70 to 90 cases that the Secretary of State would want to review in a lot more detail. Then, due and diligent inquiries would be made to try and understand the ultimate ownership of those holding companies. There would be lots of complicated diagrams drawn, no doubt, showing who owns which bit of what and who are the key individuals and shareholders. The answer would be that, I am afraid, this unit is going to have to keep digging until they get to the bottom of who are the ultimate shareholders.

The Bill is drafted in such a way that you do not need to own much in the way of shares—or there are provisions included within it such that if an entity or individuals, or individuals reporting elsewhere, have control or influence over those holding companies, that in itself would be something we would be concerned about. The Bill includes provision for that because we know, and I believe the security services are well aware, that the equivalent of layering is used for acquisition of these sorts of businesses, or people have certainly tried to do that. So, it is going to be a matter of hard work and digging to get to the bottom of who really owns and controls those entities.

Q66 Peter Grant: When you talk about a lot of hard work and digging to get to the bottom of it, does that include potentially gaining information that is not in the public domain and from a jurisdiction where that information is not allowed to be disclosed? Does that potentially mean having to rely on information that is gained covertly by British intelligence, which then cannot be shared in open court if the case is challenged?

David Petrie: I suspect that would be the corollary of that, yes. We are probably dealing with a relatively unusual set of circumstances here. It rather assumes that the shareholders of the British company are absolutely determined to sell or take investment from an entity where its ultimate ownership is quite difficult to identify. We are dealing with quite an unusual situation—not unprecedented, certainly, but relatively unusual. I do not know what resources the new unit will have at its disposal, but given that this is relatively rare and is a question of national security, I would expect that the Secretary of State would ask it to use whatever resources are necessary to gain the information it needs.

I hope—again, we will see—that the closed doors process for the judicial review, should it come to that, would enable national security to be protected, so that if there were some other breaches as a result of the investigation, or if explaining how we found out what we know caused a breach in national security elsewhere, that problem could be resolved. I am comfortable—I think that would be the right expression—that those difficulties can be dealt with in circumstances in which the absolute preferred option for the company is to take investment, but I have to say that I think those circumstances would be relatively rare.

Q67 Sam Tarry: How have you found your engagement with Government so far, and what processes are you looking for, in terms of how the Government engage with you and the industry—whether it is with your organisation or more widely? Do you have any comments on that?

David Petrie: Yes, I have. The Government have been very clear about the need to bring this legislation on to the statute book, and they have done so through the Green and White Papers. When consulting on the White Paper, they sought opinion from a very broad spectrum, including business groups, businesses, the investment community and so on. They have set that out in the response to the consultation.

The next consultation is the one on the sectors within the scope of the mandatory regime, and the next month or so is going to be a very important stage in this process. Defining those sectors in a way that market participants understand and that does not trigger manifestly unnecessary notifications is going to be very important, and we look forward to engaging in that process, as does the legal and investment profession and British business.

Q68 Sam Tarry: How do you think the mandatory notification framework could impact small and medium-sized enterprises in particular, which are obviously having a difficult time, given the consequences of the pandemic?

David Petrie: Yes, that is an important consideration. I hope that if small businesses have limited resources, that is recognised by the new unit, and that smaller businesses are able to have an open dialogue with it, and can say, "This is what we do, and this is what we need the money for. We are going to need it quite quickly because we are running out of money." If the unit is able to give unequivocal guidance very quickly, that would be very helpful.

I would also say that the new unit should not treat the 30-day turnaround for a mandatory notification as the target. The target should be to respond as quickly and efficiently as it can, and in such a way that does not cause difficulty or distress for small and medium-sized companies. A five-page form for a small or medium-sized company seeking investment for a UK or a relatively straightforward overseas entity is not a terribly burdensome obligation. I hope that it will be possible for them to find their way through that at relatively low cost.

The Chair: I do not think there are any more questions, so once again I thank you, Mr Petrie, for generously giving your time to assist the Committee.

David Petrie: Thank you.

Examination of Witness

Chris Cummings gave evidence.

4.10 pm

The Chair: We welcome Chris Cummings, the chief executive of the Investment Association. Mr Cummings, would you be so kind as to introduce yourself for the record?

Chris Cummings: Thank you for the opportunity to appear in front of you. My name is Chris Cummings, and I am the chief executive of the Investment Association. We represent UK-based fund managers, an industry of some £8.5 trillion used by three quarters of UK households today. We own roughly a third of the FTSE.

Q69 Chi Onwurah: Thank you, Mr Cummings, for sharing your expertise with us. We all recognise the importance of inward investment, and indeed of the Investment Association, to our economy. The impact assessment for the Bill estimates that up to 1,830 notifications might come in each year under the new national security

[Chi Onwurah]

and investment regime, but those numbers do not capture the fact that almost every start-up seeks capital investment at some point. The requirements to notify are put on the acquirer, but I would like your thoughts on the impact that may have on start-up companies. As part of that, I imagine it will be especially hard to hold merger and acquisition auctions while checking on the outcome of these processes. What do you foresee will be the overall impact on the UK investment climate, and in particular on the ability of our most innovative start-ups to raise capital? I am often told that access to finance is the key barrier to start-ups growing, and staying in the UK as they grow.

Chris Cummings: Thank you; that is such a pertinent question. Before I address the substance of it, I want to try to describe the work of many of my members, which is broadly portfolio investments. They seek not to acquire a company but to invest, taking a very small stake—a fraction of a percent—of those companies. That provides an opportunity for those companies to receive the investment they are looking for, and enables us as investors to invest in a company, an industry or a whole sector in order to generate a return for the investors whose money we are managing. They tend to be pension funds and insurance companies—institutional investors.

Of that £8.5 trillion I mentioned that we manage, about 80% to 85% comes from institutional investors; the other 15% or so comes from retail: people on the high street saving in individual savings accounts and so on. Our view on the Bill is about how we can continue to do our work to help finance companies in the UK and internationally with the investment collateral that we can bring to bear. We do that in the two major parts of the market: listed companies and unlisted companies.

Perhaps I can address the point you made about small and medium-sized enterprises. We make investments in unlisted companies—of course, small and medium-sized enterprises are not listed organisations—by developing an understanding of sectors and industries. We look for individual institutions that we regard as high-performing—that is, high-performing over a long period of time, because we are patient investors, tending to take a long-term view, unlike colleagues in other parts of the industry, who are more high-frequency, or looking at a two to three-year earn-out period. To help us do that, we need two things. The first is legal certainty around the investment climate here in the UK, so that we understand the rules of the game, so to speak. This particular Bill is helpful in establishing greater clarity about the rules of the game; we do have one or two caveats, but it is helpful. The other is publicly available information, such as analysts' reports—the type of thing that we as investors would look to receive and interrogate, and on the back of which we would then make an investment decision.

We are really looking for whether the Bill helps make the UK more attractive; whether it helps us funnel savings into productive investment that can help companies grow, create jobs and so on; and whether it is adding to the legal certainty of our investments. You are right to ask about SMEs; our members who invest in higher-growth companies are really keen to make sure that the process is as friction-free as possible, and that there are no surprises. Being very clear about a pre-notification regime is especially important to us, as is something like the five-year review period that could come after a deal has ended. Certainty about those 17 sectors is particularly important as well. That is why we have wanted to maintain a really close dialogue with the officials—the team that has sponsored this Bill—to make sure that no inadvertent barriers have been erected to us deploying that investment in the right way.

One of the suggestions we would like to commend to this Committee is something we have seen work particularly well in Japan, which considered a similar raft of legislation: a blanket exclusion for investment—not for takeovers, obviously, but for portfolio investment, where the investment industry wants to support unlisted or listed companies, and it is clear that there is not a desire to take them over, involve ourselves in the management of those firms, seek a position on the board or secure the intellectual property, but where we are just performing the role of long-term investor. That has been judged as being outside the scope of the legislation, but we commend that to the Committee as a practical step that takes forward the principles of the Bill and secures the "investability" of the UK's investment landscape.

Q70 Chi Onwurah: Thank you very much. I note your suggestion regarding the blanket exception for investment funds. I had two quick follow-up points: first, could you say how they would be defined in such a way that would exclude, for example, foreign sovereign investment funds and so on, which might give cause for concern? Also, you said you had a couple of caveats. I take it that is one; what is your other caveat?

Chris Cummings: Forgive me: I noticed that I missed the point about mergers and acquisitions. We regard the pre-approval facility that officials have mentioned—I believe the last witness mentioned it, as well—which is a way in which the team responsible could be approached ahead of a deal being put together, as a very sensible, practical step forward, as long as confidentiality was absolutely rigorously maintained.

In terms of definitions, we find the Japanese definition quite attractive, and again we commend it to the Committee. It clearly differentiates out investors such as the ones we represent, who are looking to provide capital for a company and share in its success for the benefit of the investors whose money we manage, but are not seeking to take an active role in the management of those companies. We are not looking to put somebody on the board; we are not looking to intervene directly in day-to-day management decisions. Our relationship is with the board chairman and so on, in order to engage in a constructive and strategic discussion, but we stop short of securing assets or taking an active role in management. That is a system that works well.

Turning to our caveats, I mentioned the five-year review period. We undoubtedly recognise the spirit in which this legislation is drafted, but Governments change, as does public opinion. The strength of this Bill is that it is focused around national security. Perhaps a definition of national security may go a little further in helping investors as well, because we could not really strike upon a catchy, well-turned phrase that defined national security, and have a reluctance to move away from national security; we would hate to see the Bill being widened into more public interest ability.

A final point to note would be the interplay between this legislation and the Takeover Panel, which has a different and distinct role to play. The notification percentages are slightly different: it is 25% in the Bill, and 30% in the Takeover Panel, so ensuring that there was no accidental misalignment would be most useful.

Q71 Nadhim Zahawi: Welcome, Mr Cummings. You mentioned the feedback from your members about keeping the Bill focused very much on national security. The message that we want to get out there is that Britain remains very much open for business, and that we want to maintain our place in the premier league of foreign direct investment. How has that statement of policy intent, which we published alongside the Bill, landed with your membership?

Chris Cummings: When it comes to a clarification point around national security, this is similar policy-intent-driven legislation to what we have seen in other emerged markets, such as the US, Germany, France and so on. We do not find that it is out of step with other developed markets. In other jurisdictions—I will take the US as an example—the legislation has started small and then grown as people have become familiar with it. The UK, perhaps because we feel we are playing catch-up—that is not for me to say—has started on a larger scale first. That is why there are queries around scope and around the durations. We look forward to engaging with the definition of the 17 sectors to ensure it is as specific as possible, and to ensure that we understand the operation. We would like to hear from officials and colleagues in ministerial positions on how they see it working in practice, so that the investment community is really clear that the rules of the game have not changed, and that the UK really is as attractive as we want it to be for incoming investment.

As I mentioned, we represent UK-based investment managers, but of course, those organisations are headquartered not only across Europe, but in other parts of the world, particularly the US. We are managing pension scheme money not only for UK savers and pensioners, but from other parts of Europe and places as far-flung as Brazil. If we as investors were looking to make an investment in UK plc, we would need to be clear about where head office was, and where the money was coming from. All those things could be either pre-approved or ruled in court as quickly as possible to ensure that there is not a missed beat in attracting the investment that we all want to see.

The Chair: Nickie Aiken.

Q72 Nickie Aiken: I forgot to say earlier that it is a pleasure to serve under your chairmanship, Sir Graham. Mr Cummings, thank you for your time today. Are there any particular areas in the Bill that concern you—that you think may put off the investment community from investing? Also, what would you say are the particular strengths of this Bill?

Chris Cummings: As for particular strengths, we feel that the aspects that deal evidently with national security are strengthening a regime that needed some modernisation.

On the protection of intellectual property, one of the key areas—it is absolutely essential for us as investors—is knowing that if we are investing in a particular company, we are doing so because, depending on the market and sector it is in, we feel that the intellectual property is clear, maintained and protected by clear legal contracts, and that if something goes awry, we, as investors, have recourse to legal sanctions.

There is much in the Bill to be commended. In terms of areas of weakness—forgive me; I feel I have touched on these—it is about ensuring that, as investors, our position is clear and understood. In investing in a company, when doing that not to try to take it over or seize the reins, it is to provide more of a long-term investment to support the company's development. We do not feel that quite comes through in the way the Bill has been written at the moment. It has been written, rightly, for takeovers. We do not want to be hit by ricochet—by accident—in wanting to continue to support UK plc and find that new barriers have been erected that prevent us doing that, simply because this part of the investment landscape had not been completely thought through. That is a caveat, rather than a point for deep consideration.

Q73 Nickie Aiken: On the 17 sectors that were included in the Bill, do you think there are too many or do you think any sectors are missing?

Chris Cummings: That is something we are looking forward to engaging with. When you first hear it, 17 sectors sounds like quite a lot, but having worked through the 17 sectors and looked at some of the draft definitions, I think that each one is justifiable.

We would be keen to point out a few things to the Government. First, the greater the specificity around the definitions, the better. Secondly, we should not rush to change the sectors by adding to them too quickly. Investment needs a degree of stability, and legislative stability most of all.

Thirdly, in consulting with industry and thinking about the operations and practice, I would ask to have industry expertise around the table. We found time and again working with officials—they are hugely valuable, talented individuals, but do not come from a commercial background, almost by definition, although some do—that having the commercial insight, we can play a role in nudging in the right area, to ensure that nothing is hard-coded that would prevent a deal because the nuance has not been appreciated. Having that industry insight would be a big step forward, if it could be accommodated.

Q74 Peter Grant: Good afternoon. The Government's impact assessment expresses the view that a national security regime such as this does not have much of an impact on overseas investors and their investment decisions, as long as they are comfortable that any interventions are appropriate and the regime is predictable. Do you share that view?

Chris Cummings: With any new piece of legislation, and certainly one of this character and this far-reaching, investors will always want to understand the motivations that led to it being introduced, how it will work in practice and whether we can give case studies as quickly as possible to prove that it does work in this way.

The important thing—I cannot stress this enough—is how it gets spoken about by Ministers. That enduring political support for investment carries such weight with investors. More than the words on the page, what matters is how it is presented—how Ministers then talk about the desire to continue to attract investment and how they make themselves available to investors.

All major economies, because of the covid-19 crisis, are seeking new levels of investment, whether for individual corporates or infrastructure investment, let alone Government debt. We feel very strongly that the UK has a tremendous story to tell. Introducing new legislation such as this at a time when, bluntly, we are looking for more investment to come into the UK, will require a degree more explanation. The way it has been phrased so far, as national security and almost as a catch-up activity with other developed jurisdictions, is fine. However, if Ministers make themselves very much available to investors to explain how this will work, and make a bonus of the pre-authorisation facility, so that if investors are troubled that an investment they are considering could attract attention, there is an ability within 30 days—that is a really important point: within 30 days—to have it pre-approved and then stood by, that will go a long way in the investment community.

As you can tell, we will have to paddle a little bit harder, but that has the potential to be a short-term explanation for a long-term gain. Potentially, that is fine, but I say again that we hope Ministers will seize the opportunity to explain this to investors, the course will be set and we will not see further iterations or scope creep from national security to other sectors, which then becomes a little more worrisome.

Q75 Peter Grant: Thank you. Decisions under this legislation will initially be taken by the Secretary of State. In the United Kingdom, the way that Ministers exercise the authority given to them by legislation, and indeed the way that Governments or Prime Ministers exercise the authority that comes down through the concept of the royal prerogative, is governed as much by tradition, convention and understanding as it is by hard legislation. Recently, we have seen an increasing number of occasions when Governments have chosen to do things that are allowed but are completely unprecedented and not according to the usual traditions and conventions. There are some notable examples here, and clearly a number of examples from the outgoing President of the United States. Does that give you a concern that legislation might be passed giving a Minister power under certain understandings, but that the understandings themselves might have no legal force, so a future Minister might exercise that power in a way that is very different from what had been expected or intended when the legislation was passed?

Chris Cummings: Forgive me, but it is obviously not my role to advise future Ministers on attitudes they may take. I can simply say, from an investor's point of view, that we prize stability, predictability and accountability beyond all things. Making sure that the rule of law applies and that there is no handbrake turn in policy direction matters hugely. Investment is being sought by every economy around the world, and it would be a very rash Minister indeed who decided to unpick something that is a great strength of the UK and one of our global competitive advantages: a system based on the rule of law and an approach to policy making that is entirely transparent and accountable to Parliament, which gives the investment community great confidence that the UK retains its position as being one of the safest places in the world to invest in.

From our perspective, that accounts for one of the reasons why our investment management industry here in the UK is globally pre-eminent. The UK is not only the largest investment centre in Europe; we are bigger than the next two or three added together. Only the US is a bigger market, and that is because of its substantial domestic scale. When it comes to international investment, the UK is streets ahead of its competitors. We would very strongly urge any parliamentarian, and certainly any Minister, to think twice before taking actions that would have a lasting consequence for our international reputation.

Q76 Simon Baynes: Thank you, Mr Cummings, for a very good presentation. I just want to go back to your point about the blanket exclusion for investment managers. First, you say that is the situation in Japan, but maybe you could say where else it exists. Secondly, why is it needed? I totally accept that, on the whole, the investments being made by your members will not fall within the trigger points, because they will not be taking over 25% of Shell or even some small companies, but they might do in certain circumstances.

Thirdly, to what extent do hedge funds represent members within your organisation? Obviously, they have greater capacity, or greater natural affinity, for investing in smaller companies—not always, but in certain cases. They might actually fall within the remit of the triggers, so I do not quite see how we could implement the blanket exclusion, if from time to time there are exceptions to the exclusion.

Chris Cummings: Thank you for asking me to clarify; I apologise that I was not as clear as I should have been. The hedge fund community has a representative organisation. It is a splendid one that can do a tremendous job in speaking for them, and I would not put myself in that position; I would not try to speak for them. We have members that invest substantially through private markets into smaller and unlisted companies. Again, it comes down to intention. The intention is not to invest in such a way as to take over the company and to seize the reins; the intention is to make an investment that is in the strategic direction of the company, to support its growth.

I am trying not the use the term "passive investment", because we are anything other than passive when it comes to investing, but it is an approach that is designed to support the company, rather than to change dramatically the company's ownership or direction, or to land one of our members on its board—in effect, they would then be part of the management and governance of that company. I hope it is more than a subtle definition; it is a distinction with a real difference. That is part of why we think it is an important distinction to make.

Other jurisdictions have been through similar experiences. The Japanese example is so relevant, because it is only a year or so ago that the Japanese Government were considering very similar legislation. As a result of consultation, they came up with the approach that we are suggesting: to exclude the activities of investors, insurance companies and so on, because it is around the intentionality—not wanting to take an active role in the management or to change the company's direction, but to support through investment rather than to seek control.

The US has a similar modus operandi. It is not quite as framed in the legislation as it is in Japan—again, just through history. The approaches that we have seen in Germany and France also nudge in the direction that I am describing, so there are parallels. The Japanese experience is the closest match that I can offer the Committee, but we will continue to do further investigations and to feed in ideas through the Bill's stages and through the consultation on individual sectors.

Q77 Simon Baynes: There is a fairly fine line in smaller companies in which an investment manager takes a major stake. There is a fairly fine line between having an active role in its management and having very close scrutiny of its management. From my own experience in the business, the investment manager keeps a very close eye on it in those cases. If they do not, quite a lot of risk is involved. That is quite a crucial grey area, and it therefore makes me think that a blanket exclusion would create problems. It might be viewed by private equity companies or whatever as being an unfair advantage to investment managers.

Chris Cummings: Certainly, we are keen to see those smaller and medium-sized companies get access to as much growth capital and investment as they need. Part of our enthusiasm for this piece of legislation, and indeed others, is that it is an opportunity to re-excite the UK public about the opportunities for equity—for shareholder participation in fast-growing companies. That is partly why we are so keen to work with your Committee and others to communicate the message.

Perhaps a clearer distinction could be found for the difference between listed and unlisted companies. That is perhaps where we could focus our attention more, on explaining—I am not sure that "blanket exception" is quite the right language for me to use because that seems to be a one-and-done exercise and perhaps there would be more to it than that—but focusing the attention on the listed sector, where it is much more obvious that we as investment managers are investing for the long term rather than seeking control over the company. I hope that would allay some of the concerns that you rightly mention.

Q78 Matt Western: Thank you, Mr Cummings, for being a witness today. I want to come back to the point about capacity in terms of the mandatory notifications. As described, do you think it is going to be able to cope with that, and just how opaque are some business organisations and ownership? With that opacity, will they realistically get to that within 30 days? That is my first question. Secondly, in terms of many transactions, the Government have no legal powers over retaining jobs or research and development in the UK—thinking about SoftBank, Arm and many others. Do you think there is a need to plug those sorts of gaps or deficiencies?

Chris Cummings: You rightly raise the question of scale and resources. It is one of the things we have been consulting our members on, and having discussions with others, to try and get a better view of what the notification process would be, who would notify, who would then respond, the scale of the team in the Department that would be exercising due diligence in the applications and whether the system could cope. Bluntly, what would concern us deeply is having a 30-day notice or turnaround period that the Department regularly missed, because that would then create a shadow over this particular piece of legislation. It would gum up the works and, frankly, none of us would wish to see that.

Looking at how the regime works at the moment, with very few notifications, there seems to be a scale difference between where we are today and what the legislation proposes. We would like to hear more from Ministers on how they are going to address that and what the processes would be. There have been discussions about a portal, a very brief form of five pages or so that would be easy to complete, but I think a degree more of reassurance on that point would not go amiss—as would the confidentiality. There is so much around any investment process and the acquisition process that has to remain entirely confidential, that investors would require and would be looking for reassurance that these conversations could be held in the strictest of confidence and that nothing would appear until the right time. In terms of scale and resources, it is a point that we share your interest in.

I was making a note of the point you raised on transactions, but could you repeat that part of the question? Apologies.

Q79 Matt Western: No problem. It was just about various deals, with the example of, say, SoftBank and Arm, and the protection of jobs, research and development and pensions in the UK, and whether the Government need to plug that gap to give assurance and protection here in the UK to those elements.

Chris Cummings: Thank you, and apologies again for omitting that. This is something that we, as the investor community, have been observing for the last few years at least, looking at the different requirements that Governments have tried to put on acquiring companies—Kraft Cadbury and so on, through to SoftBank—and seeing what has happened there, and the role that the takeover panel has been asked to play to police or report on those activities.

The intent behind the Bill at the moment seems to be for national security to preserve intellectual property in that R&D capacity here in the UK. If that is going to be seen through, transparent and accountable mechanisms need to be clarified in the Bill, on how that will work in practice, what resources will be in place to measure, monitor and report it, to whom it would report, and any sanctions that would be applicable afterwards. Those are definitely areas that we feel deserve further scrutiny.

From our point of view, as investors, the last thing we want is to invest in companies where we feel the IP is protected and the R&D facility is well known to us, but where within one, two or three years there has been either a change of management or further changes that mean that IP has been moved or duplicated elsewhere. That is a very legitimate concern.

The Chair: If there are no further questions, I thank you very much on behalf of the Committee for giving your time and assistance, Mr Cummings.

Ordered, That further consideration be now adjourned.—*(Michael Tomlinson.)*

4.46 pm

Adjourned till Thursday 26 November at half-past Eleven o'clock.