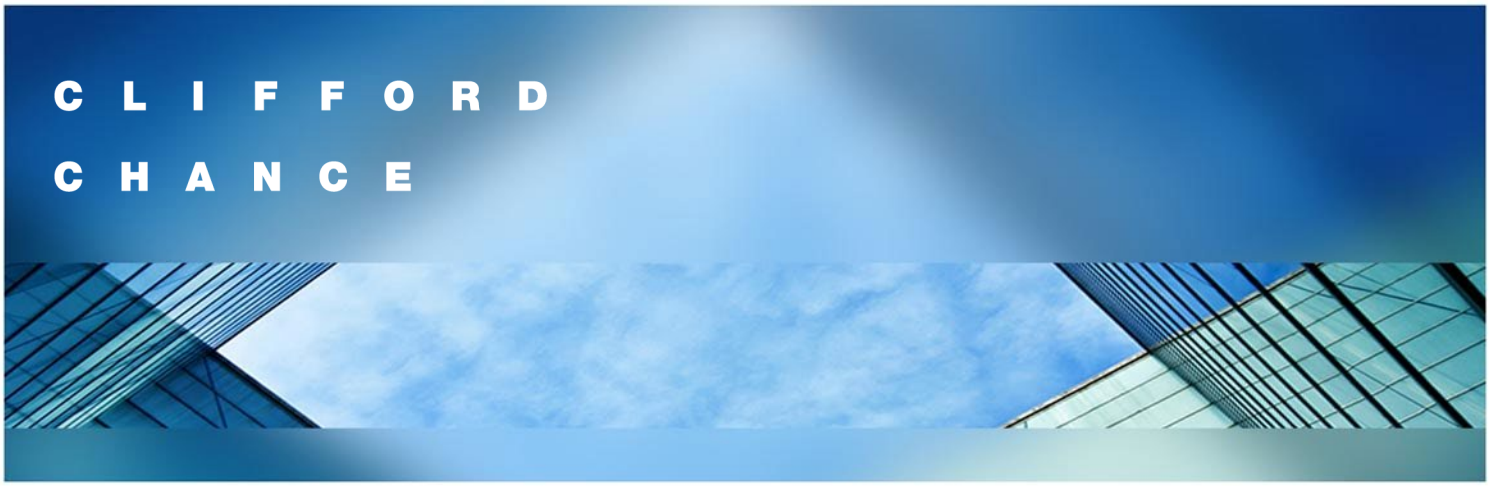

PROPOSED REFORMS AND RECENT STATISTICS FOR THE UK NATIONAL SECURITY MERGER SCREENING REGIME

The UK Government has announced that it intends to exempt certain intra-group transactions from the mandatory filing requirements of the National Security and Investment Act 2021 (**NSIA**). It is also consulting on proposed changes to the definitions of "sensitive activities" that determine whether other transactions are notifiable, which would refine several of the existing definitions, while adding certain activities in the water sector.

Separately, the Government has published its annual report on the operation of the NSIA, providing insights into the types of transactions and investors affected by the regime.

THE NSIA'S ROLE IN A SHIFTING REGULATORY AND POLITICAL CLIMATE

The consultation on the NSIA regime comes at a time of continued government willingness to demonstrate pro-business credentials. The proposed changes suggest that the UK Government is trying to make the NSIA regime simpler and more targeted at deals most likely to raise national security concerns, while safeguarding its core missions of delivering economic growth and improving living standards.

At the same time, national security remains high on the agenda. The Strategic Defence Review, published earlier this year, pledged to spend 2.5% of GDP on defence in the current Parliament, while the National Security Strategy 2025 commits to spending 5% of GDP on national security by 2035. Large-scale investment in defence-related areas is therefore expected in the coming years.

Against this backdrop, while the UK's Modern Industrial Strategy has called for "*a predictable, proportionate, and transparent investment screening framework,*" the consultation itself largely weighs in favour of preferencing the protection of national security. It predicts that the proposed changes will likely lead to an **increase** in the number of notifications.

RELIEF FOR RESTRUCTURINGS: INTERNAL REORGANISATIONS SET FOR REFORM

While the consultation itself increases the number of businesses in scope of the regime, the press release accompanying the consultation states that forthcoming changes to the NSIA regime will remove the requirement to notify "*certain*" internal reorganisations. This is welcome news and may lead to a net reduction in the number of notifications. Currently, even routine internal restructurings – where the ultimate parent remains unchanged – can require mandatory notifications, creating unnecessary regulatory burdens and delays for businesses as well as additional work for the Investment Security Unit (**ISU**) in reviewing transactions that pose no new national security risks. The proposed change would align the UK more closely with other European foreign investment regimes, which typically exclude certain internal reorganisations.

Equally pragmatic and welcome is that the appointment of liquidators, special administrators, and official receivers is also set to be excluded from the mandatory regime, aligning their treatment with that of administrators.

REFINING THE REGIME: SECTOR-SPECIFIC CHANGES TO THE NSIA

The Government is proposing various changes to the definitions of sensitive activities which, if carried out in the UK by an investment target, would trigger a mandatory filing requirement. These proposed changes will not affect the Government's ability to call in and review a qualifying transaction (in any sector) even if it is not subject to a mandatory filing obligation.

- **Water:** The consultation requests views on creating a new mandatory notification requirement for acquisitions relating to the water sector. The proposed changes would capture transactions involving the 17 regional water and sewage monopolies operating in England and Wales but would not capture retailers in the non-household retail water market. The Government considers that this change would capture no more than five notifications a year on average and that it reflects increasing risks to the resilience of critical UK infrastructure, which is expected to receive £100 billion of investment in the next five years.
- **Critical Minerals:** It is proposed that these are removed from Advanced Materials and added as a standalone category of sensitive activities. The new schedule will also update the definition of critical minerals in line with the UK's criticality assessment and add activities involving the extraction, processing, and recycling of critical minerals (the latter change is expected to bring up to 50 additional businesses within scope of the regime).
- **Semiconductors:** The existing definitions of activities in this sector will also be moved to their own standalone schedule, to which the Government intends to add activities involving advanced packaging techniques and activities involving the wider design process of processing units and memory chips, including research and development. This change is intended to make the definitions easier to apply and is not expected to expand the scope of businesses caught by the definition, as businesses that would be caught by the expanded definition would already have been captured by another activity.

- **Artificial Intelligence:** A positive development is the significant refinement of the AI sector definition. The changes would: (i) remove from scope cases where 'off the shelf' AI that is available to consumers is used solely for internal processes, without any further development of it; and (ii) change the definition of in-scope AI activities to focus on systems that create or enhance AI capabilities, or increase computational speed (in place of the previous focus on certain applications such as advanced robotics and cyber security). These changes are expected to reduce the number of businesses in scope by up to 50.
- **Other refinements to existing definitions:** Changes will also be made to the advanced materials, communications, critical suppliers to government, data infrastructure, suppliers to emergency services, energy, and synthetic biology sectors. Most of these refinements will either clarify or rationalise the existing definitions or reduce the scope of activities that are caught. However, the Government expects that changes to the data infrastructure definitions (inclusion of third-party operated data centres, data processing and storage facilities, and those offering peering/interconnection or subsea cable connections) and suppliers to emergency services (inclusion of certain sub-contractors) will each catch around 50 additional businesses within the scope of the mandatory filing regime.

ANNUAL REPORT 2024-25: KEY INSIGHTS

- **The volume of notifications is up**: 1,143 notifications were submitted in the reporting period – over 25% more than the previous reporting period – with the overwhelming majority (954) being mandatory notifications. This continues the trend of parties not routinely submitting precautionary voluntary filings, which we expect to continue as businesses and advisors become more accustomed to the ISU's practice.
- **Call-ins and final orders**: The number of called-in transactions (56) increased by more than 25% compared to the previous year, broadly in line with the increase in notifications. However, the number of final orders following a call-in has more than tripled (17, accounting for 33% of all transactions called in and only 1.5% of all notifications) compared to the previous period (five). Of the 17 transactions subject to a final order, 16 were cleared subject to conditions and only one was ordered to be unwound.
- **Nationality of affected investors:** UK investors received more than half of the final orders (11 of 17), followed by China (seven) and the US (three). UK investors also accounted for the largest share of transactions that were called in (48%); a notable change from the previous period, when the largest proportion involved Chinese investors (41%). This underscores that the NSIA is, at its core, country-agnostic: the origin of the investment, even if local or from a "friendly" state, may not affect the final assessment of whether a national security risk arises, in particular if the target has sensitive capabilities that the government wants to retain in the UK, or has sensitive data or facilities to which the government wants to control access. However, it remains the case that Chinese investors face the highest risk of having their deals called in, given that they accounted for only around 2% of all notifications to the ISU (in contrast to UK investors, who accounted for 65% of notifications). They are also more likely to have their deals blocked or unwound at the end of the call-in review, as opposed to being cleared with conditions. In the relevant reporting period, the only

unwinding order was imposed on a Chinese-registered investor and, to date, all but one of the transactions that have been prohibited or unwound under the NSIA concerned Chinese investors, with the one exception concerning Russian investors.

- **Retrospective validation applications**: 55 retrospective validation applications were submitted, up from 33 in the previous year. While completing a notifiable acquisition without approval remains a criminal offence, the Annual Report notes that the ISU has not yet pursued enforcement, likely due to the regime's relative infancy – though this leniency may not continue.
- **Sectoral Focus**: Defence remains the most affected sector, accounting for 56% of all notifications (up from 48%), 36% of call-ins (up from 34%) and 53% of final orders. Other sectors in the spotlight include Military and Dual-Used Items, Critical Suppliers to the Government, Advanced Materials, and Energy.
- **Review timelines remained broadly consistent with the previous period**: All initial assessments were completed within the statutory 30 working day review period, with the ISU typically accepting notifications within a week, and the Chancellor of the Duchy of Lancaster (**CDL**) taking a median of 24 working days to issue a final notification and 70 working days to issue a final order following a call-in. The averages for final notifications and final orders exclude periods covered by "stop the clocks", and will therefore understate, potentially materially, the average timeline.

IMPLICATIONS FOR INVESTORS

The CDL, in the foreword to the Annual Report, emphasises that economic security is national security and reaffirms the Government's primary mission is to deliver economic growth and improve living standards. This comes through in both the Annual Report and the consultation. The Annual Report records a sharp increase in the number of final orders issued (17, including one unwinding order) compared to the previous year (five). Although this is at odds with the Government's pro-investment stance, the fact that UK investors were more frequently subject to these orders than foreign investors – including those from China – demonstrates the regime's origin-neutrality and reinforces the UK's continued openness to foreign investment.

Moreover, although the messaging accompanying the consultation focuses on an intent to "cut red tape", the NSIA regime remains wide in scope, and the amendments to the sectors contemplated by the consultation will likely widen the scope further still. 1,143 notifications were submitted in the Annual Report reporting period, compared to, for example, 261 in Germany in 2024, 309 in France in 2023, and 233 long form notices and 109 declarations in the US in 2023. Only 17 of these notifications resulted in remedies. The consultation could therefore be seen as a missed opportunity to properly grapple with a regime that currently captures a great deal of transactions that have no impact on national security.

However, the long-awaited exemption for certain intra-group transactions is a potential sign of a more business-friendly approach. While it is unfortunate that the proposed exemption has not yet been developed, and risks therefore being further delayed, it will reduce unnecessary costs and delays for investors with businesses that are active in a sensitive sector in the UK.

Businesses with experience of the NSIA regime are encouraged to respond to the consultation on the scope of the sensitive sectors. The consultation runs until 14 October 2025. Please reach out to us for further information on the NSIA and on foreign investment / national security screening regimes globally.

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