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CFIUS Goes Global: New FDI Review Processes Proliferate, Old Ones Expand

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Takeaways

- Since 2018, the U.S. and several other countries have revised or installed national security-related screening of foreign direct investments.
- Many jurisdictions now require filings for investments in the defense and security sectors, critical infrastructure, advanced technologies and sensitive personal data, or where state-backed investors are involved.
- While the CFIUS review process in the U.S. often remains the stiffest hurdle, the growing number of jurisdictions with similar regimes means that investors and parties to mergers must plan carefully for the review process.
- With the encouragement of the U.S. and EU, many reviewing authorities now frequently share information.

In 2021, more than a dozen countries enacted or significantly changed foreign direct investment (FDI) review processes. Some countries with relatively mature screening regimes, including Australia, Canada, China, France, Germany, Japan, New Zealand and Spain, strengthened or expanded them. Others, such as the Czech Republic, Denmark, the Netherlands, Saudi Arabia and Slovakia, implemented review schemes for the first time.

More reforms will follow in 2022, led by the U.K.'s National Security and Investment Act (NSIA), which took full effect on January 4, 2022. Other countries are expected to introduce significant legislation (*e.g.*, Ireland and Norway) or publish new FDI technical guidance (*e.g.*, France).

Several factors explain the expansion of these reviews:

- **A common "threat."** Many governments traditionally receptive to FDI have expressed concerns about the intentions of state-backed investors from nonmarket economies. For example, the European Commission's (EC's) first annual report on FDI screening, released in November 2021, noted a "clear change in investor profiles and investment patterns, *i.e.*, increasingly non-OECD investors, occasionally with government backing or direction, whose motivation for a particular investment might not always be exclusively commercial."
- **EU regulatory developments.** The Foreign Direct Investment Screening Regulation, which became fully operational in 2020, has dramatically expanded FDI review and related information sharing across the EU.
- **Emerging technologies.** More governments now recognize the significant role emerging technologies play in national security and defense. With recent supply chain disruptions in the semiconductor and other industries, technological sovereignty is seen as a particularly important issue.
- **U.S. government encouragement.** Since the passage of the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018, the U.S. Treasury has engaged with dozens of countries on FDI screening. The act directed Treasury to "facilitate the harmonization of action" on FDI by conferring favored status on countries with reliable screening mechanisms. This directive could have a farther reaching impact than FIRRMA's other changes to the existing review process under the Committee on Foreign Investment in the United States (CFIUS).

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- **The continuing COVID-19 pandemic.** Several countries have established or strengthened FDI review as an emergency measure to avoid pandemic-related opportunism, renewing and extending these measures as the crisis continues.

See "Institutional Investors, Activists and Legal Reforms Begin Altering Japanese Corporate Governance."

Keys to Successfully Navigating FDI Reviews

While the CFIUS review process remains the most challenging and the one most likely to result in obstacles for a deal, the expansion of FDI requirements in other countries highlights the importance of developing a sound cross-border strategy for navigating this issue.

- **Early on, assess the necessity of FDI reviews for investments in sensitive industries.** In broad strokes, virtually all the major FDI review mechanisms focus on the defense and security sector, critical infrastructure, raw materials and inputs (energy products, minerals, food security), advanced technologies, mass media and sensitive personal data. Cross-border investments in these categories are the most likely to trigger FDI reviews.
- **Recognize that investor-related due diligence is essential.** A number of FDI regimes require filings for transactions involving state-backed investors, sometimes even for passive investments. Private equity and other investment partnerships therefore must be prepared to disclose information about their limited partners and partnership agreements during FDI reviews.
- **Understand and submit mandatory filings.** Most FDI regimes now require mandatory and suspensory filings for at least some transactions, usually with certain exemptions or waivers. We foresee more penalties imposed for noncompliance, led by the U.S.
- **Expect increased coordination between review authorities.** Parties should assume that information provided to one FDI regulator will be sent to others.
  - **European Union.** EU regulations create a notification mechanism to facilitate information-sharing between member states and the EC, and the EC reviewed over 400 such cases between October 2020 and November 2021. An FDI filing in one EU country may result in questions from others. FDI regulations also encourage member states and the EC to cooperate with non-EU countries.
  - **United Kingdom.** The NSIA allows the U.K. government to disclose information obtained in an FDI review to foreign authorities for various purposes, including to protect national security.
  - **United States.** Expect more formal cooperation between CFIUS and other FDI authorities, because FIRRMA provisions make sharing information with counterparts easier.
- **Allow more time for FDI reviews.** With more jurisdictions requiring filings, parties need to plan for lengthier reviews. Even jurisdictions with time limits and mechanisms to expedite reviews may fail to meet their deadlines due to increased FDI workloads. Implementation of the EU's FDI cooperation mechanism has already caused delays and longer review periods in some member states.
- **Anticipate the need for mitigation in sensitive cases.** FDI regulators now more commonly condition approval of sensitive transactions on mitigation measures addressing security concerns, which can materially impact governance and operations of the acquired business. Regulators are also increasingly monitoring existing mitigation commitments.
- **Engagement with FDI regulators is critical.** With so many new, revised and expanded FDI review mechanisms, parties must be prepared to engage early and proactively with regulators regarding jurisdiction, control and co-investments (particularly involving investment funds), mandatory filing requirements, filing thresholds and timing. In some cases, informal outreach in advance of filing to gauge its need or likelihood of success can yield invaluable information.

FDI Approvals Have Grown More Complicated but Can Be Navigated Successfully

Even with enhanced screening and more aggressive jurisdiction assertions, most FDI filings are approved. In 2020, approximately 80% of cases subject to full U.S. filings or formal EU member state notifications were cleared without conditions, according to data published by government regulators. Another 10% received approval with conditions or "mitigation," while the remaining 10% were withdrawn or (in a handful of cases) formally prohibited.

These figures conform to our experience that robust FDI-related analysis in the due diligence phase can help identify and weed out transactions that will face problems during a review in the U.S. or elsewhere, and compliance and engagement with regulators can maximize prospects for success.