IFLR
INTERNATIONAL FINANCIAL LAW REVIEW
June / July 2019

Is the enhanced Cfius policy regime causing the US economy more harm than good?

Dr Harry G. Broadman, partner and chair of the emerging markets practice at Berkeley Research Group LLC, Washington DC and faculty member, Johns Hopkins University

The enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) and the subsequent administrative regulations implemented to date, have redefined both the role and the procedures of the Committee on Foreign Investment in the United States (Cfius) as the entity devising and executing national security regulation of foreign direct investment (FDI) into the US. Compared to the period when I served on Cfius – in the early 1990s – when Cfius was hardly the household name it is today, certain criteria and 'rules of the game' have become far more transparent and regularised.

That, in my view, is all to the good. But, ultimately, it will depend on who is in the driver's seat.

As was always the case, the direction of the decisions taken by Cfius will remain conditioned by the philosophy towards inbound foreign investment of the occupant of the White House. Regrettably, under the current administration, that posture is generally more protectionist than it ever has been in our lifetime. The result is less rigorous – and interdisciplinary – thought given to carefully weighing the domestic growth opportunities engendered by foreign investment versus the potential risks, including devising innovative measures outside the strict confines of the Cfius framework to help mitigate such risks.

The link to this article published in the June /July 2019 issue of *International Financial Law Review* is: https://www.iflr.com/Article/3882737/IFLR-magazine/Head-to-head-Is-enhanced-Cfius-policy-causing-the-US-economy-more-harm-than-good.html

At the same time, given the breadth of FIRRMA, the statutory authority underlying how Cfius is to operate has greatly expanded. The significant imprimatur of Congress on Cfius now means that the legislative branch has a far more visible and strengthened oversight role of the agency than previously. While it would be naïve to think that Cfius' processes in and of themselves were ever immune to politics, those risks now have likely increased.

> **One key takeaway is that navigating Cfius is no longer simply a legal matter**

The combination of the current protectionist executive branch and a more systemic politicised arena in which Cfius must now operate, may well add up to Cfius taking decisions today that could curb the international competitiveness of the US economy in certain sectors that might not be apparent for years.

Much has been made of two dimensions of Cfius' operations that FIRRMA has altered.

First, while previously parties to a transaction were not obligated to pre-notify Cfius prior to the closing of a deal, the new law requires this. Frankly, in the pre-FIRRMA era, my counsel to such parties was almost always to pre-notify since there is always the risk that Cfius may unwind or force a divestiture following the closing of a transaction. To think that a transaction with borderline national security risks would escape scrutiny was foolish.

Tensions have been rising between the US and China in recent months

Second, under FIRRMA, Cfius will get the authority to scrutinise non-controlling investments in companies that maintain or collect personal data of citizens that "may be exploited in a manner that threatens national security". On the one hand, the proposition that investments in these particular activities stand alone as posing far greater risks compared to investments in other sectors is debatable. On the other hand, it is sound reasoning to recognise that majority ownership may not always sufficiently counteract the control effects of minority shareholders.

One key takeaway is that navigating Cfius is no longer simply a legal matter. Those naïve enough to still see it that way – a view that was myopic to begin with – will not fare well under FIRRMA. Cfius is now by far an issue of business strategy: how best to both structure the transaction and design a risk-mitigation protocol–with such steps made ready for execution even before the parties to a deal formally close the transaction.

Another conclusion is that, notwithstanding the current administration's protectionist stance, it would be ill-advised to interpret FIRRMA as a fundamental re-orientation of US policy toward foreign investment. Yet that is the prevailing belief in some markets – most notably China.

In light of the current trade war with the US, it is certainly understandable why Chinese firms and investors would "write off" the US market. Developing a pragmatic, fulsome operational strategy of the best way to manage the Cfius process, however, would be the wiser course of action.

Samson Lo, head of M&A at UBS, Hong Kong

Since the implementation of the Cfius reforms in August 2018 there has been a significant decline in China-into-US deals. Volumes in 2018 stood at $7.9 billion compared to the all-time highs of $64.3 billion achieved in 2016. Unsurprisingly, the media and other commentators have focused on the correlation between the introduction of Cfius with the slowdown of China-into-US deals but the enhancement of Cfius has also served to encourage Chinese buyers to be more thoughtful; due diligence in advance of launching a bid on a US target is now more robust than previously. At the same time, Cfius has been a catalyst in creating a more mature cross-border deal-making environment for the US and others.

Cfius has also prompted greater diversification. Chinese buyers are broadening their scope to encompass acquisitions in Europe as well as in industries in which the US has a limited presence, with the Nordic region an increasingly popular new hunting ground. Concurrently, China-into-Europe deals are becoming increasingly complex; a recent example being China Resources Beer's series of cross-ownership and collaboration agreements with Heineken for a total transaction value of $3.9 billion on which UBS advised the acquirer.

> **Cfius has been a catalyst in creating a more mature cross-border deal-making environment for the US and others**

However, with Chinese buyers off the scene, Japan and Korea have stepped into the breach, which has helped negate the decline in deals flowing into the US. For example, in September 2018, UBS advised a consortium of Korean corporates and private equity funds in their acquisition of Momentive in the US for $3.1 billion. In fact, Korea-into-US volumes reached $6.5 billion in 2018, a 158.4% increase year-on-year, while Japan-into-US volumes stood at $31.6 billion in 2018 following an historic high of $45.7 billion in 2017.

Several completed China-into-US deals have been re-reviewed and, in some cases, the Chinese owners are in the process of divesting the targets. A natural buyer universe is the US so, ironically, the re-trades have, on occasion, helped US targets find their way home.

Last year, the Chinese government relaxed the barriers to control by foreign investors in several sectors. These include insurance and asset management companies, banks, and auto manufacturers. As a result, Europe-into-China volumes have burgeoned, increasing by around 8.6 times to $9.9 billion in 2018.

However, in contrast, US-into-China volumes declined from $6.7 billion in 2016 to $6.2 billion over the same period. But clearly, the current political environment is not conducive for US companies seeking to invest in China with a view to assuming management control.