STIMSON

REPORT

Trade & Technology
Trade and Investment
Security Program

Foreign Direct Investment (FDI) Screening: A Primer

By Andrea Viski, Ph.D.

June 2024

ABOUT STIMSON

The Stimson Center promotes international security and shared prosperity through applied research and independent analysis, global engagement, and policy innovation.

About the Program

The Trade and Investment Security Program provides solutions, tools, and networks of research and practice to enhance the benefits of goods and technology flows while mitigating their security risks. The program provides publications, best practice tools, network-building, training, capacity-building, and research solutions. Through these activities, we work with and empower regulators, industry, academia, and international organizations to enhance implementation of export controls, sanctions, and foreign direct investment screening.

Acknowledgements

This Primer was made possible with funding from the U.S. Department of State's Export Control and Related Border Security Assistance program.

The author sincerely thanks all of the individuals who took the time to thoroughly review drafts of this Primer and provide their invaluable expertise and feedback.

Please Cite this Publication As

Andrea Viski, Ph.D., June 2024, *Foreign Direct Investment (FDI) Screening: A Primer*. The Stimson Center, Washington D.C., USA.

June 2024

Foreign Direct Investment (FDI) Screening: A Primer

By Andrea Viski, Ph.D.

Table of Contents

1. Summary 5

2. What is Foreign Direct Investment? 6

2.1 Definition and Scope 6

2.2 Types of FDI 6

2.3 What is FDI Screening? 7

2.4 Inbound vs. Outbound Investment Programs 7

3. FDI Screening Objectives: Balancing Benefits and Risks 8

3.1 FDI Risks and Benefits Overview 8

3.2 Military/National Defense & Security 9

3.2.1 Technology 9

3.2.2 Sensitive Personal Data 11

3.2.3 Real Estate 12

3.2.4 Critical Infrastructure 12

3.3 Functions Vital to Society 12

3.3.1 Public Safety 12

3.3.2 Public Health 12

3.3.3 Critical Infrastructure 13

3.3.4 Supply of Critical Inputs 14

3.4 Public Order 14

3.5 Freedom and Pluralism of the Media 14

3.6 Protection of National Cultural Traditions 14

3.7 Foreign Policy-Related 14

3.8 Other Objectives 15

3.9 Conclusion 15

4. Elements of FDI Screening Legislation and Implementation 16

4.1 Dedicated vs. Non-Dedicated Screening Mechanism 16

4.2 Elements of FDI Screening Legislation and Implementation 17

4.2.1 Scope 17

4.2.2 Conditions and Thresholds 18

4.2.3 Exemptions 19

4.2.4 Competent Authorities 19

4.2.5 Review Process 21

4.2.6 Timelines 21

4.2.7 Information Parties Must Provide 21

4.2.8 Fees 22

4.2.9 Completion Report 22

4.2.10 Criteria for Decision-Making 23

4.2.11 Remedies 23

4.2.12 Penalties 24

5. FDI Screening Guidelines and Good Practices 25
5.1 Overview and Methodology 25
5.2 Organization for Economic Cooperation and Development (OECD) FDI Screening Guidelines 25
5.2.1 Non-Discrimination 26
5.2.2 Transparency of Policies and Predictability of Outcomes 26
5.2.3 Regulatory Proportionality 26
5.2.4 Accountability 26
5.3 Good Practices for Consideration 26
5.3.1 Consultation Regime 26
5.3.2 Exemptions 27
5.3.3 Standstill Obligation 27
5.3.4 Retroactivity 27
5.3.5 Definitions 28
5.3.6 Mitigation Agreements 29
5.3.7 Monitoring Compliance with Mitigation Agreements 29
5.3.8 Enforcement 31
5.3.9 Penalties 31
5.3.10 Remediation Plans 32
5.3.11 Annual Reports 32
5.3.12 Stages/Phases of Screening 32
5.3.13 Appeal Mechanism 33
5.3.14 Advance Consultation/Pre-Screening 33
5.3.15 Requirement of Post-Investment Report 34
5.3.16 Confidentiality 34
5.3.17 Non-Partiality 35
5.3.18 Translation 35
5.3.19 Risk Assessments and Risked-Based Reviews 35
5.3.20 Updating Regulations and Implementation Practices 35
5.3.21 Outreach and Public-Private Consultation 36
5.3.22 Impact Assessments 36
5.3.23 Expert Input in Policy-Making 36
5.3.24 Adequate Resources for Competent Authorities 36
5.3.25 Information Exchange with Foreign Counterparts 37
5.3.26 Guidance on How to File and Fill Out Forms 37
5.3.27 Technical Reachback 38
5.3.28 Long-Term Strategic Vision 38
6. Summary, Key Takeaways, and Perspectives on the Future 39
7. Further Resources 40
Endnotes 41

Table of Contents: Example Boxes

Example 1: United States FDI Screening and Export Controls 10

Example 2: FDI Screening and Ports 13

Example 3: Designated Sectors in Japan 18

Example 4: The Danish Investment Screening Act 19

Example 5: The United States Committee on Foreign Investment in the United States (CFIUS) 20

Example 6: Malta's Notification Form 22

Example 7: European Union Regulation 2019/452 23

Example 8: Australia's FDI Screening Consultation Regime 27

Example 9: Turkey's FDI Screening Regulatory Definitions 28

Example 10: United States Practices and Procedures for Monitoring Compliance with Mitigation Agreements 30

Example 11: Penalties in Germany 31

Example 12: Belgium's Screening Phases 33

Example 13: Japan's Post-Investment Report Requirement 34

Example 14: United Kingdom's Website Guidance 37

1. Summary

Foreign Direct Investment (FDI) forms an important component of global economic growth and competitiveness, providing long-lasting links and integration between economies and societies. The benefits of FDI are well documented and recognized, with the following presenting a non-exhaustive list: increased employment, economic growth, human resource development, international trade promotion, social progress, development of regional economies, finance and technology provision, increased exports, innovation, access to informal/formal networks, and improved capital flow. With FDI serving as a crucial indicator of global integration and economic health, most countries have historically sought to maximize favorable FDI conditions.

Over the last several decades, many countries have recognized that the bountiful opportunities brought by FDI could also come with risks. While each country may perceive these risks in their own way and with their distinct security concerns in mind, the mechanism most often used to ensure that FDI benefits and risks are properly managed is Foreign Direct Investment (FDI) screening. This term refers, on a general level, to procedures for assessing, investigating, authorizing, conditioning, prohibiting, or unwinding FDI.[1] Through FDI screening, countries can attract quality FDI and protect their national security interests simultaneously.

This FDI Screening Primer is a resource for countries considering developing FDI screening measures, as well as for countries with FDI screening mechanisms in place who wish to update, strengthen, review, reform, or expand their current framework. The Primer's objective is to provide neutral, high-quality, useful information and good practices for an FDI screening system, ultimately for the purpose of positively maximizing FDI benefits while minimizing risks. The Primer offers FDI stakeholders a useful toolbox for deepening understanding of FDI screening, implementation practices, and what the future may hold for this quickly developing field.

The objective of this Primer is to be descriptive, not prescriptive, so that countries can consider and apply FDI screening frameworks, regulatory components, and good practices which account for their own national contexts and based on their own careful and thoughtfully considered assessment of national security interests.

This resource is composed of several easily navigable sections meant to be user-friendly, clear, concise, and widely applicable. The Primer's first section covers FDI basics, such as what FDI is, kinds of FDI, the definition of FDI screening, and important distinctions in order for readers to fully understand the basic concepts discussed in the rest of the document. The Primer's next section provides information on the overall objectives and justifications guiding different countries' frameworks, followed by a section covering different implementation models and the components of FDI screening regulations and systems that exist worldwide. The Primer then offers a section composed of a repository of good practices that can be considered by countries seeking to develop or strengthen their FDI regimes. The Primer concludes with a summary of main points and perspectives on what the future may hold for global FDI screening practices. A list of resources in the last section gives readers options for further reading.

2. What is Foreign Direct Investment?

2.1 Definition and Scope

The Organization for Economic Cooperation and Development (OECD) defines FDI for statistical purposes as a type of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.[2] Key to this concept is that investment of funds must have the intent of establishing a "lasting interest," in concrete terms this could mean, for example, even a minority percentage of voting power in another organization. Other activities which constitute investment vulnerabilities and are discussed in the context of this Primer include, for example, access to sensitive data and technology. FDI can also refer to reinvestment of profits from overseas operations and organizational loans to overseas subsidiaries. Individual investment laws may define investment in different ways. Importantly, FDI may lead to transfer of not just capital—money—but also to other flows, such as technology, skills, and processes. As part of this, FDI may come with access to sensitive data. FDI and other foreign investment can take several different forms and take place in many ways, meaning that countries must be able to tailor relevant structures, legislation, and implementation accordingly.

The "direct" part of Foreign Direct Investment differentiates this activity from non-direct investment, or what is called Foreign Portfolio Investment (FPI). FPI involves foreign individual or entities buying stakes in companies on a foreign stock exchange. Except for limited cases, FPI will not be considered in this Primer.

Individual investment laws, include those governing investment screening, may define investment in different ways.

2.2 Types of FDI

FDI can be categorized in several different ways. One way is by looking at the type of investment:

- **Horizontal FDI:** a company establishes the same type of business operation in a foreign country as it operates in its home country. It does not change its core activities.
- **Vertical FDI:** a business acquires a complementary business in another country, usually in order to strengthen its supply chain.
- **Conglomerate FDI:** a company invests in a foreign business that is related or unrelated to its core business. This can be done with the intent to build more business niches.

- **Platform FDI:** expansion of a business to a foreign country, but everything manufactured there is exported to a third country.

In addition to this useful categorization, types of FDI can also be described according to the following terminology:

- **Greenfield:** the creation of a new company or establishment of facilities abroad.
- **Brownfield, also called Merger & Acquisition FDI:** transferring the ownership of existing assets to an owner abroad. In a merger, two companies are merged to form one, while in an acquisition, one company takes over the assets of another, either partially, as a percentage acquisition, or in their entirety.

The last helpful categorization of FDI refers to capital vs. non-capital FDI. While capital investment refers to acquisition of physical assets by a company (ports are a good example of this), FDI can also involve monetary investments that result in controlling interest or voting stock of a company, and mergers and acquisitions.

2.3 What is FDI Screening?

Foreign direct investment screening refers to a review of individual FDI transactions subject to and based on a set of jurisdiction-specific criteria. Screening can mean, as referenced in the Primer Introduction, procedures for assessing, investigating, authorizing, conditioning, prohibiting, or unwinding FDI. Implementation of an FDI screening mechanism is meant to ensure that certain kinds of FDI comply with the expectations of country-based defined rules.

2.4 Inbound vs. Outbound Investment Programs

Inward investment screening refers to FDI coming into a country where the transaction comes under review by home country authorities.

Recently, some countries have also adopted or are considering new authorities pertaining to the regulation of outbound investment. Outbound investment programs focus on investments stemming from the home country going to a foreign country. Under outbound FDI review schemes, the foreign countries and specific industrial sectors where investment comes under review are delineated by the regulation of the home country. Generally, outbound investment programs are implemented to curtail technology transfer risks as well as for specific foreign policy and other national security-related objectives.

This Primer only pertains to inbound investment screening.

3. FDI Screening Objectives: Balancing Benefits and Risks

3.1 FDI Risks and Benefits Overview

Countries implement FDI screening policies in line with their national rules as well as in light of international treaty obligations. Countries implement FDI screening to maximize the benefits of FDI while minimizing security risks. The justifications within national legislation for FDI screening are as varied as the country-specific risks perceived, and the two are closely linked. This section delineates the types of objectives countries identify in their FDI screening mechanisms and links each objective to the potential risks they are meant to address.

The following list is comprehensive based on a survey of countries' legislation and public policies related to FDI screening. The Primer author has reviewed existing legislation and FDI screening systems of jurisdictions worldwide. Based on this research, the following section offers a comprehensive list of objectives. While translation and language differ from country to country, there are broad categories of objectives, within which more specific objectives can also be categorized or overlaps identified. This provides a clear structure for the section.

The objectives for FDI screening necessarily vary by country and based on how each country perceives risks. Importantly, countries often revise and update the sectors subject to screening based on national, regional, and international factors, and often revise or expand objectives periodically based on evolving technology, foreign policy, and other factors.

It is key to note that FDI screening does not equate with prohibiting. Sectors that fall subject to screening due to investments that meet certain criteria or thresholds go through a screening process that differs country to country. As will be explained in section 4 of this Primer, countries use a variety of methods to ascertain which transactions fall under a screening requirement, and some countries even allow for organizations to file voluntarily or conduct post-facto screenings. The results of these screenings are rarely prohibitions on the transactions taking place—in other words, investment screening is not a red light—green light process. Most mechanisms offer a way for the government to impose mitigation terms on a transaction which would allow the transaction to proceed, if the conditions the government identified to address an identified risk are met. Thus, the FDI screening mechanism facilitates the government having greater control over how a transaction takes place, clearer information, and, if necessary, the ability to put specific protection measures in place or prohibit the transaction from taking place altogether. As the OECD identifies in its guidelines from 2009, a key point is that FDI screening programs should be proportional to identified risk in a transaction and only go as far as necessary to protect national security while still allowing business to proceed unencumbered.

Additionally, FDI screening systems should not deter quality FDI. A key takeaway from this Primer is that having a thoughtful FDI screening system in place is a way to ensure that good quality FDI enters a country—inclusive investment that promotes economic and societal growth and development in a safe, secure, and lasting way. Investors appreciate clear regulations that promulgate stable rules and foreseeable effects. The rules should always be as clear as possible on the front end. When screening systems have a clear basis, are linked to understandable objectives, and are implemented in a transparent, fair, and easy-to-understand way, investors will be confident in the security of their investments.

In general, the trend in recent years has been for the introduction or adaptation of FDI screening measures worldwide. One of the key underlying factors driving this trend has been changes in technology which have affected the way threats can manifest. Another factor is heightened awareness and concern over investors tied to and acting on behalf of certain countries that seek to accelerate their modernization by acquiring companies and assets in sectors that put at risk the investment recipient country's national interest, and that certain FDI transactions can create dependencies. National security considerations have driven countries to reevaluate whether adequate protections are in place to counter FDI risks, and which sectors they view as sensitive or vulnerable. Additionally, the Covid-19 pandemic led many countries to recognize supply chain risks and vulnerabilities, leading to the adoption of FDI screening measures to an array of efforts mitigate them.

The following list of objectives can be useful for FDI stakeholders when considering the landscape of risks associated with FDI. It is important to note that through this Primer separates FDI screening objectives for clarity, in practice many of the following objectives are cross-cutting and may overlap, especially with the national security-specific objectives in section 3.2.

3.2 Military/National Defense & Security

The most common objective that countries refer to in their FDI screening legislation and policies is national defense, which, depending on the country, can be referred to as, for example, national security, national defense, or military defense. The objective of screening FDI in defense and defense-related sectors is to protect against threats posed by foreign individuals and entities that could acquire defense-related interest, influence, assets, and technology through FDI, thereby threatening the national security interests of a country.

3.2.1 TECHNOLOGY

Defense and security related FDI threats are particularly acute in the context of the development of **emerging technologies**. These technologies can be omni-use and many of their uses cannot be foreseen, so that applications in areas like biology, social engineering, and others may be of concern in a national security sense, even if not explicitly linked to an existing military item of use. The sub-objectives under national defense that are specified in national FDI screening laws include reference to **access to sensitive information** or **technology leakage**.

FDI can pose a particular concern in the context of technology transfer because FDI generates benefits that are unavailable when using other modes of technology transfer, such as trade and/or licensing. FDI brings technology as well as complementary resources such as human resources and know-how, capital

reserves, marketing and sales experience. In many cases, this transfer is beneficial, if not crucial, especially in developing economies. However, especially with regards to sensitive and/or dual-use technologies, FDI screening can mitigate the risks and vulnerabilities posed by dual-use technology transfers.

Examples of technologies in this area include artificial intelligence, 3D printing (additive manufacturing), biotechnology, robotics, position, navigation & timing technology, quantum computing, and more. Because foreign direct investment in dual-use technologies could potentially threaten national security by giving foreign investors access to sensitive technology, many countries have adopted screening mechanisms to be able to stop risk-prone transactions before they are finalized, or to work with involved parties to ensure the transaction takes place with certain risk mitigation conditions and measures in place.

Governments may also consider appropriate authorities to address potential security risks in the area of academic and research organizations. These sectors are particularly vulnerable to security risks stemming from investments due to the dual-use nature of many research areas as well as the relative lack of awareness within academic and research communities of technology transfer-related security threats. Governments may consider any such risks in contexts including contract or sponsored research, sponsoring research positions or themes, or licensing intellectual opportunities.

Because different and evolving emerging technology industries exist to varying degrees in different countries and regions, countries often specify in their FDI legislation what kinds of technology sectors come under FDI screening requirements, and periodically revise and update their legislation to ensure it encompasses what is necessary to protect national defense and security objectives.

EXAMPLE 1: UNITED STATES FDI SCREENING AND EXPORT CONTROLS

In 2018, the U.S. Congress passed the Foreign Investment Risk Review Modernization Act (FIRRMA).[3] The law was passed to strengthen and modernize the Committee on Foreign Investment in the United States (CFIUS) to address national security concerns more effectively. CFIUS is the interagency committee authorized to review certain transactions involving foreign investment in the U.S., and FIRMMA expanded CFIUS's scope in terms of FDI screening. Importantly, FIRMMA and the Export Control Reform Act (ECRA) were passed both in 2018 and while they did not significantly alter the underlying structure of either CFIUS or the U.S. export control system, they linked investment screening more explicitly to export controls. While ECRA tightened U.S export control policies, FIRRMA updated the process for screening inbound foreign direct investment to counter threats to U.S. technological competitiveness and protect the U.S. supply chain in national security-relevant technologies.

Importantly, ECRA and FIRRMA established for the first time a direct link between export controls and inbound foreign direct investment controls. FIRRMA and its implementing regulations establish mandatory CFIUS filings for certain foreign investments, based on categories of items that are export controlled. One category where such filings are now mandatory when there is an amount of foreign government control include certain transactions

involving a foreign investment in a U.S. business that produces, designs, tests, manufactures, fabricates or develops a U.S. critical technology, which is defined as certain items controlled for export under various U.S. laws/regulations guiding export controls including the following:

- U.S. Department of State International Traffic in Arms Regulations (ITAR);
- U.S. Department of Commerce Export Administration Regulations (EAR);
- U.S. Department of Energy regulations regarding the export and import of nuclear equipment and material, as well as assistance to foreign atomic energy activities;
- U.S. Department of Agriculture regulations on the possession, use and transfer of select agent and toxins; and/or
- Emerging and foundational technologies designated under ECRA.

By defining critical technology this way, FIRRMA clearly links the responsibilities of CFIUS with those CFIUS member agencies that administer U.S. export control laws.

It is important to note that many countries have tied their FDI screening systems in the critical and emerging technology area to export controls. Export controls establish licensing requirements before the export of certain materials, equipment, and technology to specified destinations, end-users, or end-uses can take place. Because export-controlled goods and technology are generally dual-use, meaning that they can be used for both civilian as well as military end-uses, establishing mandatory FDI screening mechanisms for investment in organizations that produce those goods is a model increasingly adopted worldwide to ensure that security interest are not compromised. In this context, it is useful to note that FDI screening should not duplicate existing export controls. For example, if technology transfers are controlled by export controls, there may be no need to control the investment separately to address the same risk.

3.2.2 SENSITIVE PERSONAL DATA

Another category of national defense-related screening applies to sectors that have access to **sensitive personal data** of a nation's citizens. The acquisition of such data can pose security threats because it can expose citizens to exploitation. This kind of data can vary in nature and what is considered sensitive. Examples of the kinds of data that countries may consider sensitive from a security standpoint include, but are not limited to:

- Financial
- Mental, physical, psychological health-related
- Geo-location
- Data used to apply for security clearances
- Results of genetic tests
- Consumer-behavior data

3.2.3 REAL ESTATE

Some countries choose to screen Foreign Direct Investments in real estate. In the context of real estate, investments can refer to certain acquisitions, leases, and concessions that give a foreign investor access and control rights in the property, which should be clearly defined in the FDI screening legislation. Screening of real estate transactions can take place based on the proximity of the real estate to military bases and strategic ports and the rights of the foreign investor in the real estate, such as real estate that can be used for sensitive activities.

3.2.4 CRITICAL INFRASTRUCTURE

(*refer to section 3.3.3*)

3.3 Functions Vital to Society

FDI screening mechanisms are often established to ensure that foreign investment does not threaten industries key to the safety and operation of a country. At the heart of FDI screening in this area is a commitment by a country's government to the "**public good**," a concept that refers to the provision of goods and services that benefit all members of society. Objectives grouped in this category and referred to by countries in their national legislation include:

3.3.1 PUBLIC SAFETY

Industries such as law enforcement, emergency communications, fire, rescue, and emergency medical services are vital to ensuring that countries can maintain public safely. Foreign direct investment, if not adequately screened for potential threats to the public good, can jeopardize the smooth functioning of these important sectors.

3.3.2 PUBLIC HEALTH

Especially since the Covid-19 pandemic, countries have become sensitized to the importance of having mechanisms in place to ensure that industry sectors and supply chains crucial to *pandemic response* are protected. Some countries have even introduced measures to screen acquisitions in sectors that could be hurt by temporary financial stress during a pandemic. Examples of sectors included under this category include biotechnology, companies that develop, manufacture, or produce vaccines, medicines, protective medical equipment, and other medical goods and technology, as well as sectors that could target public heath sectors due to "opportunistic investment behavior" in the context of a pandemic.

3.3.3 CRITICAL INFRASTRUCTURE

Examples of critical infrastructure vary by country. Typically, this category includes sectors such as energy, transportation, telecommunications, or information technology. Especially for developing countries and emerging economies, FDI in critical infrastructure is a key priority and essential for economic growth, job creation, and competitiveness. However, protection of critical infrastructure is also important in order to ensure that these sectors function adequately and without interruption—again, for the public good. The protection of critical infrastructure through FDI screening often overlaps with national security FDI screening objectives, though in some cases the two are delineated separately in national legislation. Screening FDI in critical infrastructure is further important to ensure that foreign countries do not acquire disproportionate control over key sectors.

EXAMPLE 2: FDI SCREENING AND PORTS

Investment in ports is a key enabler, with benefits for trade, economy, and society. Importantly, under the concept of public sector interest, ports should be accessible to all potential users and benefits from ports should go to all citizens. However, because the public sector may have difficulty adapting to user needs and maintaining efficiency, allocating resources between the public and private sector can ideally ensure that the public interest is met. FDI can be a key enabler of port creation, modernization, and growth.

Older ports, coupled with insufficient roads and intermodal connections, can lead to higher costs, missed berthing slots, delays, and overall disruption to the maritime supply chain. The importance of modern, efficient ports was made even more clear in part due to the effects on global supply chains of the Covid-19 pandemic. Therefore, many countries have opted for investments to create green ports—those that invest and encourage environmentally friendly and sustainable operations—as well as smart ports, which use innovative technologies and automation to optimize and improve performance (or a combination of smart/green ports).

While FDI can provide opportunities that many countries seek to enable port modernization, having effective FDI screening in this critical infrastructure area can ensure that the source of the FDI meets certain criteria and does not risk national security and/or create harmful dependencies. In addition, many of the technologies used in smart ports can make countries vulnerable to security risks without proper screening. For these reasons, having a long-term investment vision—one that includes country-specific objectives aligned with screening mechanisms—can ensure good quality, secure, and sustainable FDI in ports.

3.3.4 SUPPLY OF CRITICAL INPUTS

Critical inputs refer to goods that a country relies on to function, such as energy, raw materials, and food. To assure that supply of these inputs can adequately sustain a country's population, countries implement policies to protect these sectors. In addition, many countries see an interest in having a certain degree of national supply of critical inputs, so as not to be reliant on other countries, and fluctuations in price and supply that may cause. Protecting that national supply is the objective of FDI screening in this area.

3.4 Public Order

Public order is one of the objectives referred to by some countries in their FDI screening legislation, such as in the European Union. This concept comes from international humanitarian law, where it refers to the general conditions that must exist so that a country's citizens can enjoy their rights and freedoms. Other concepts or definitions of public order in national and international law are difficult to identify. The term public order is generally not defined. The consideration that comes with not defining public order is that foreign investors may consider the risk too big to pursue investment when the sectors that fall under public order are not transparent.

3.5 Freedom and Pluralism of the Media

Some countries implement FDI screening for investments in national media to avoid a foreign country and/or an individual/entity from having disproportionate control over the flow of information to citizens. Especially with the threats posed by mis/disinformation, social media exploitation, and profit-driven organizations in charge of media, some countries find it important to protect their national media and screen investments in this field.

3.6 Protection of National Cultural Traditions

Though rare, some countries invoke the protection of national cultural traditions as an objective of FDI screening. While specific sectors are not delineated in the national legislation of countries that have implemented this, the sectors involved may relate to the arts as well as cultural sectors reliant on tourism, such as national historic or natural sites.

3.7 Foreign Policy-Related

Some countries implement country-specific screening requirements based on their foreign policy objectives. This means that FDI originating from the individuals/entities of a certain country fall immediately, or after meeting certain criteria, under a screening requirement. The reasons for why countries implement country-specific requirements vary based on their own national risk assessments and the geopolitical/security context they find themselves in. In principle, and as well be discussed in

section 5, FDI screening should take place in a neutral way. However, in the case where investments from certain countries comes under mandatory review or prohibition as spelled out in national legislation, this guideline does not apply.

3.8 Other Objectives

Some countries have introduced FDI screening mechanisms under which host country authorities authorize their screening mechanisms to review foreign investments to evaluate whether they present net benefits to their economies. This assessment follows set criteria that authorities consider when screening in the context of this objective, such as the impact on economic activity, the degree of participation of home country citizens in the organization formed as part of the transaction, the effect of the transaction on productivity, industrial efficiency, or technological development, or the contribution to the ability of the host country ability to compete in world markets.

3.9 Conclusion

A shifting threat environment brought on through expanded trade and accelerated technology innovation suggests a need for an informed and coordinated approach that follows an aligned, integrated, and comprehensive strategy. This approach is essential to ensure that national policy interests and objectives are achieved. Such an approach promises more effective outcomes and avoids potential unintended consequences.

4. Elements of FDI Screening Legislation and Implementation

There are several elements that contribute to FDI screening systems. This section will explain the fundamentals of FDI screening legislation and implementation.

4.1 Dedicated vs. Non-Dedicated Screening Mechanism

It is important to note the difference between dedicated and non-dedicated screening mechanisms. Many countries have an FDI screening system in place, but that screening takes place for different sectors and is regulated according to dispersed, separate legislation under the authority of different government ministries and agencies. For example, with a non-dedicated mechanism, there may be a regulation that calls for screening of certain FDI transactions in the mineral sector of a country under the auspices of the Department of Energy or Natural Resources. The same country may have a separate regulation that calls for screening of FDI in media, under the auspices of the Department of Culture or Communications. Usually, in these cases, decisions on screening take place within one agency given their authority according to the legislation rather than an inter-agency process. Moreover, in these cases, there is not one government agency or authority with overall decision-making power and authority over investment screening decisions.

With a **dedicated** FDI screening mechanism, there is a "dedicated" national law that outlines a screening procedure, its objectives, specific sectors, processes, timelines, criteria, decision-making, relevant authorities, enforcement, and other critical information. That legislation forms the basis of the FDI screening regime as well as designates one ministry, agency, or body (such as a council or committee) within the government to be the designate authority for all screening processes. This does not mean that other governmental bodies with competence in specific screening areas are not consulted—in fact, the authoritative body will usually be the one leading inter-agency consultations.

Having a dedicated FDI screening mechanism has several benefits. First, it provides potential investors with a clear and transparent framework to use for their decision-making regarding potential investments. Investors prefer to work within clear and predictable frameworks, and therefore having a dedicated mechanism with clear legislation and procedures can work to make a country potentially more FDI-friendly. Second, having a dedicated mechanism can foster a clear division of responsibilities, roles, and decision-making power amongst different government bodies which avoids overlaps, confusion, and inefficiencies. Third, a dedicated mechanism allows for greater confluence of vision and conceptual basis directing FDI investment screening which ultimately supports the criteria, parameters, and decision-making legitimacy of screening authorities.

While there are benefits to dedicated FDI screening mechanisms, it is the prerogative for each country to decide what processes and systems are is most appropriate—there is no "one size fits all" approach. Some countries may choose to focus on particular sectors and not others.

This Primer focuses on the elements of FDI screening legislation and implementation that underpins dedicated screening mechanisms.

4.2 Elements of FDI Screening Legislation and Implementation

The following section describes the main elements of FDI screening legislation and implementation. There is significant variability depending on specific country FDI screening systems between all of these components. In keeping with this Primer's objectives, the following section will provide information on key elements that countries may wish to consider when developing, strengthening, or expanding their FDI screening systems.

4.2.1 SCOPE

FDI screening first and foremost defines scope, meaning what kinds of activities fall within the investment system and why. Defining scope necessitates laying out which of the objectives (as listed in section 3) form the underlying justification for transactions that should be screened, as well as which sectors are affected. Countries often define a list of "designated" sectors that fall under FDI screening review. Whether a business falls within the scope of designated business sectors can also be defined differently and can be based on factors such as the business purpose, its or its subsidiaries' articles of incorporation, and/or based on their actual business operations.

Scope varies greatly between countries, as each have their own national security and public order conceptions, for example. In addition, the scope of FDI screening legislation is the section that countries most often amend in order to add new sectors or new objectives.

EXAMPLE 3: DESIGNATED SECTORS IN JAPAN

Japan's FDI screening regulation, the Foreign Exchange and Foreign Trade Act (FEFTA), designates certain business sectors where investors must file prior notification.[4] The regulation further defines "core business sectors" where investment could undermine national security. The sectors are defined as follows:

Designated business sectors (core business sectors)

- Manufacturing of weapons, aircrafts, nuclear facilities, space products, semi-conductors, and dual-use technologies;
- Pharmaceutical and special medical device manufacturing businesses;
- Metal mining related to significant mineral resources;
- Certain cybersecurity-related business (such as network security monitoring, service providers of the programs designed for critical infrastructures); and
- Certain infrastructure-related business (such as electricity, gas, telecommunications, water supply, railway, and oil).

Designated business sectors (non-core business sectors)

- Other software business, data processing service business, and internet-use support business;
- Other infrastructure-related business; and
- Heat supply, broadcasting, public transportation, biological chemicals, security services, agriculture forestry and fisheries, air transportation, and maritime transportation.

4.2.2 CONDITIONS AND THRESHOLDS

This section of an FDI screening regulation must clearly explain exactly which conditions must be met for a transaction to fall under the scope of a review regime. For example, while the scope of the regulation may outline which broad sectors may be involved, this section contains information regarding exactly to what specific conditions or investment thresholds apply.

Thresholds generally refer to percentage votes reached or exceeded, or shares owned, by the transaction that makes it subject to review. This number differs depending on the country in question, and different thresholds can differ across applicable sectors. Therefore, when countries update their FDI legislation, thresholds are often changed along with the scope of sectors included.

This section of legislation also delineates what transactions can nevertheless fall under the scope of review even if they do not meet the criteria and thresholds specified: these are called **non-covered transactions**. Often, regulations allow parties to a non-covered transaction to voluntarily submit information regarding the transaction.

EXAMPLE 4: THE DANISH INVESTMENT SCREENING ACT

The Danish Investment Screening Act came into force on July 1, 2021. Certain transactions fall under mandatory review when the foreign direct investment leads to a foreign investor holding what is called a **qualified holding** in a Danish business.[5] A qualified holding is defined as direct or indirect possession of or control of at least 10 percent of the shareholding or voting rights or equivalent control by other means. Equivalent control by other means can be shareholder agreements, loan agreements, finance agreements, etc., that grant the foreign investor control over or significant influence on the managerial or financial matters of the company or on its development or operations. The obligation to file for approval applies not only if a qualified share of 10 percent is attained, but also if the qualified share is subsequently increased to 20 percent, a third, 50 percent, two thirds or 100 percent.

The Danish regulation also includes a **Call-In Regime**, described in Part 3 S. 10 of the Regulation. This refers to non-covered transactions, whereby foreign investors not covered by the criteria above may submit a notification to the Danish authorities of an intended or completed foreign direct investment if it may pose a threat to national security or public order and the foreign investor directly or indirectly obtains possession of or control over at least 25 percent of the shares or voting rights in a company domiciled in Denmark or equivalent control by other means.

4.2.3 EXEMPTIONS

Even when sectors, criteria, and thresholds are outlined in the FDI screening regulation, some countries delineate exemptions meaning that if certain additional circumstances apply or conditions are met, the transaction is exempt from a filing requirement. These exemptions can apply based on the national origin of the investor, the nature of the investment, and the business sectors/level of investment involved. Exemptions can also apply if the transaction took place during a specific date or within a specific timeframe preceding an investment screening regulation.

4.2.4 COMPETENT AUTHORITIES

National FDI screening regulations must contain information regarding a) the primary government body with review and decision-making authority for FDI screening b) any other government bodies involved in the FDI screening process and their role vis-à-vis the primary body c) any other government bodies in the review or appeal process. In some countries, a distinct commission, agency, or committee is created with the sole purpose of centralizing review and decision-making power on FDI transactions. These distinct bodies are usually within an inter-agency process where other government agencies are referred to, or take part in, FDI screening processes. In other countries, an existing Ministry (and agency within it) is identified and authorized as the primary review and decision-making body and can be assisted by other Ministries/agencies. In terms of final authority, some countries allow for ultimate decision-making to reach the highest levels of executive power.

EXAMPLE 5: THE UNITED STATES COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS)

CFIUS was originally established in 1975. In 1988, CFIUS was also given the power to review or advise the President to prohibit specific transactions. The Chairperson of CFIUS is the Secretary of the Treasury, and notices to CFIUS are received, processed, and coordinated among the CFIUS members by the Treasury Department.

The members of CFIUS include the heads of the following departments and offices:

- Department of the Treasury (chair)
- Department of Justice
- Department of Homeland Security
- Department of Commerce
- Department of Defense
- Department of State
- Department of Energy
- Office of the U.S. Trade Representative
- Office of Science & Technology Policy

The following White House offices also observe and, as appropriate, participate in CFIUS's activities:

- Office of Management & Budget
- Council of Economic Advisors
- National Security Council
- National Economic Council
- Homeland Security Council

The Office of the Director of National Intelligence is an *ex officio* (non-voting) member. Other government agencies and offices are queried to review transactions on a case-by-case basis.

4.2.5 REVIEW PROCESS

While countries differ in their screening processes, there are general processes that are typically spelled out national regulations. Transactions that fall within the scope of "covered" transactions—that is, meeting the scope, criteria, and any thresholds within the regulation, usually must file paperwork with the relevant competent authority through a system delineated in the regulation that notifies and/or applies for approval or authorization. Each country's regulation specifies the timeframe during which this process must take place before the transaction proceeds. In many cases, different types of transactions are required to follow different procedures—with some requiring approvals and other notifications. In addition, FDI screening systems that include voluntary notifications will also describe the process for how these notifications must take place within the regulation. In certain countries, filings can be made after transactions take place, if they fall within conditions delineated by the regulation.

4.2.6 TIMELINES

Regulations give specific timelines for what happens after a party has filed, meaning, from the date that the competent authority receives a filing, how long it takes them to make a decision, whether that period can be extended, if an expeditious review can be requested and if so in what circumstances and at what cost, and after what time period transactions can be considered approved.

In countries that implement **prior notification**, transactions falling under the screening regime must submit notification of an intended transaction prior to the transaction taking place by a certain—defined—number of days or months. Authorities then review the prior notification. In some cases, foreign investors can move ahead with the transaction after a certain number of days following submission of prior notification. During the review period, authorities may send questions or ask for further details or clarifications regarding the transaction. Legislation should explain the documentation, information, and process for prior notification to take place.

Regulations will also specify timeframes for appeals if that is a feature of the FDI screening system.

4.2.7 INFORMATION PARTIES MUST PROVIDE

Foreign investors must know what information to provide in their filings. Regulations spell out how this information must be transmitted to the relevant authority. Usually, there is an online form, and in some cases, signed hard copies must also be provided. Questions required of investors will differ from country to country.

EXAMPLE 6: MALTA'S NOTIFICATION FORM

Malta's notification form for assessing FDI by its competent authority, the National Foreign Direct Investment Screening Office, requires investors to submit the following information:[6]

- Name of the investor and name of the target undertaking
- Description of the investment
- Approximate value of the investment
- Date when transaction is planned to be completed or has been completed
- Funding of the investment and its source
- The investor's business strategy behind the investment
- If the investor is financially able to ensure the continuity and proper operation of the target undertaking after the acquisition
- If the investment enables or results in the investor's effective participation in the management of the undertaking subject to screening
- Participation of the direct investor and its global ultimate owner in the capital of the undertaking subject to screening before the transaction (if applicable) and as a result of the transaction—before and as a result of the transaction
- If the ownership is less than 100%, how the ownership shares translate to control or participation in the effective management and the modalities of "joint" exercise of control or participation in the effective management
- If the investment is likely to affect projects or program of European Union interest
- If the transaction has been announced to the public.

4.2.8 FEES

Some countries require investors to pay a fee for filing. If this is the case, the rationale, amount, and procedure for paying the fee should be defined in the regulation. For example, countries may wish to charge a fee so that taxpayers are not the ones to bear the costs of the FDI screening review process. Alternately, some countries may wish not to charge a fee to encourage compliance.

4.2.9 COMPLETION REPORT

If a transaction falls under a screening regime and is subject to review, some countries mandate investors to file a post-transaction completion report detailing information about the transaction to the relevant authorities. In countries that have adopted this practice, their legislation also specifies the modality of submission.

4.2.10 CRITERIA FOR DECISION-MAKING

Many FDI screening regulations specify, in addition to overall objectives defined in the legislation scope, criteria or factors that public authorities use in making their determinations regarding a transaction. Some countries have a large number of specific criteria, while others have less. Having specific criteria spelled out in legislation can give foreign investors a better sense of their responsibilities under the screening regime and what to expect from the review process. It also benefits local companies, as they cannot attract investors who may be concerned that the transaction will not be permitted or will be unwound.

EXAMPLE 7: EUROPEAN UNION REGULATION 2019/452

In January 2022, the European Union adopted Regulation 2019/452 establishing a framework for the screening on foreign direct investments in European Union Member States.[7] Article 4 sets out "Factors that may be taken into consideration" in FDI screening, and in addition to factors tied to broad objectives, the Regulation also delineates the following criteria:

> "(a) whether the foreign investor is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or significant funding;
>
> (b) whether the foreign investor has already been involved in activities affecting security or public order in a Member State; or
>
> (c) whether there is a serious risk that the foreign investor engages in illegal or criminal activities."

On January 24, 2024, the European Commission proposed a new regulation to repeal and replace the existing regulation.[8]

4.2.11 REMEDIES

If the authorities responsible for screening determine that there is a concern regarding a transaction pursuant to the screening review, regulations should explain what remedies may take place. Remedies most commonly include:

- The transaction can take place subject to certain conditions or changes
- Divestment is ordered
- The transaction is prohibited from proceeding

Once the investor is notified of the remedy, if they do not follow or do not reply, authorities can take further actions, in the form of stopping transactions and/or applying penalties.

4.2.12 PENALTIES

Enforcement is a key area of implementing FDI screening. If parties responsible for filing do not file, or provide false information as part of their filing, it is necessary to impose penalties to deter and punish. Penalties vary widely between countries and are still an evolving dimension of FDI screening systems. National systems commonly impose the following types of penalties falling under, depending on the system, civil and/or criminal law:

- Divesture
- Lapse of rights
- Reversal
- Directing parties to comply with written undertakings
- Financial penalties for each day that parties are in contravention to FDI screening legislation
- Financial penalties for non-compliance
- Prison sentences (in general, sentences range between a few months and five years in most jurisdictions, with nuance to account for the significance of the transgression).

5. FDI Screening Guidelines and Good Practices

5.1 Overview and Methodology

The elements of FDI screening mechanisms explained in section 4 cover many common features of systems around the world. However, details within each element—and how they are implemented in practice—differ significantly. Because there are few international standards thus far that set standards for FDI screening systems, as well as no international regulatory or policy-making body that has power over national systems (such as at the United Nations level), national systems can be varied and account for different bureaucratic structures, and definitions of national security and public order interest.

Identifying good practices can be useful for countries that are considering creating, expanding, reviewing, and/or strengthening their FDI screening systems. Good practices are features of an FDI screening system that produce effective outcomes if followed; because of this, countries can learn from existing good practices instead of starting from scratch. This Primer's objective is to identify good practices found in FDI screening systems worldwide and share them in order to strengthen the effectiveness of national frameworks.

This section of the Primer identifies specific good practice elements that countries may consider valuable when applied to their own system. While some may be relevant and useful, others may not; it is up to each jurisdiction to consider and implement the practices they view as most appropriate to reaching the objectives of their FDI screening framework.

The practices noted in this section have been identified through a methodology of comprehensive research, data collection, and analysis by the Primer author.

5.2 Organization for Economic Cooperation and Development (OECD) FDI Screening Guidelines[9]

The OECD is an international organization composed of governments of 38 democracies with market-based economies that collaborate to develop policy standards to promote sustainable economic growth. The OECD adopted its "Recommendations on Guidelines for Recipient Country Investment Policies relating to National Security" in 2009 to help governments maintain fair treatment of international investors while meeting their countries' security needs. The Annex contains four specific guidelines:

5.2.1 NON-DISCRIMINATION

In reviewing transactions, governments should treat similarly situated investors in a similar fashion. If doing so compromises national security, other measures can be implemented based on the specific circumstances of the transaction.

5.2.2 TRANSPARENCY OF POLICIES AND PREDICTABILITY OF OUTCOMES

The objectives, scope, criteria, and procedures regarding the investment screening regime should be clear and transparent to all stakeholders. This increases the predictability of outcomes, which is a key factor in ensuring that the balance between attracting FDI and precluding risks is met. This clarity should be provided on the front end, and not based on the outcome of reviews only. Specific measures that enhance transparency and predictability are described in section 5.3.

5.2.3 REGULATORY PROPORTIONALITY

Prohibitions, conditions, or other remedies prescribed by competent authorities on transactions falling under FDI screening review should not exceed what is necessary protect national security. These actions should only be implemented if other measures, such as sectoral licensing, competition policy, or financial market regulations cannot address concerns over the transaction.

5.2.4 ACCOUNTABILITY

The FDI screening system should include procedures for internal oversight by relevant executive, legislative, and judicial government organs, periodic regulatory impact assessments, and requirements that important decisions include mechanisms to ensure accountability of decision-makers.

5.3 Good Practices for Consideration

Research and analysis of national FDI screening practices has yielded numerous good practices that can support effective implementation and help countries reach the specific national interest objectives they have within their own systems. This section briefly explains each of these practices and how they may enhance the strength of the FDI screening system. The practices described here can be adopted depending on a specific country's objectives, needs, capacity, and profile.

5.3.1 CONSULTATION REGIME

Because of the breadth of sectors included in most countries' FDI screening systems, different ministries and agencies will have specific competence regarding the risks posed by transactions in sectors under their purview. While there is usually one designated head committee, agency, or office in charge of organization, management, and heading up FDI review efforts, a consultation regime set up for that

designate to confer with other relevant government bodies ensures that the competence necessary to properly analyze transactions is in place. Targeted inter-ministerial steering committees and advisory committees can also play a useful role in the FDI screening process.

EXAMPLE 8: AUSTRALIA'S FDI SCREENING CONSULTATION REGIME

Australia's Foreign Acquisitions and Takeovers Act 1975 and the Foreign Acquisitions and Takeovers Fees Impositions Act 2015, along with their associated regulations, form the basis for its FDI screening system.[10]

Foreign investors must notify the Treasurer of proposed foreign investments if they fall under the scope of review. The Treasurer is the designated body within the Australian government that has decision-making power. When making foreign investment decisions, the Treasurer is advised by the Foreign Investment Review Board (the FIRB), which is an advisory body supported by a secretariat located within the Department of the Treasury and the Taxation Office. The sectors on which each body advises is differentiated: the Treasury advises on general administration of the FDI screening framework in relation to business, agricultural land and commercial land proposals, while the Taxation Office administers foreign investment into residential real estate.

5.3.2 EXEMPTIONS

While FDI screening regulations identify the scope of review systems and who must file, it can be useful to specify exemptions for filing and reviewing transactions. Typically, exemptions can apply to certain sectors, transaction values, or countries of FDI investment origin, and can be updated or modified to align with national objectives.

5.3.3 STANDSTILL OBLIGATION

When a standstill obligation is in place, an investment may not be closed until the screening process is completed and the investment has been approved or a decision to close the case without further action has been taken. In some countries, standstill obligations apply to transactions in certain sectors but not others. It is important that standstill obligations clearly define what is meant by the closing of a transaction, such as the exercise of voting right and/or access to sensitive information.

5.3.4 RETROACTIVITY

Several countries have opted to introduce the ability for authorities to screen FDI transactions retroactively. This means that they can screen transactions that have already taken place, within clearly

elucidated boundaries, such as 1) a specific date from which covered transactions can be reviewed and 2) the sectors, criteria, thresholds, and other defining characteristics of transactions that can fall under retroactive review. Retroactive review must still be time limited, so that there is a point at which investors can be sure that their transaction will not be unwound.

5.3.5 DEFINITIONS

National FDI screening regulations should ideally include a section on key definitions, which varies between countries depending on which terms they view as important to define. Common terms defined or elaborated upon in national legislation include, but are not confined to:

- Foreign Investor
- Foreign Direct Investment
- Screening
- Screening Decision
- National Security

Having clear definitions in legislation is important in order for investors to know exactly what the targets, objectives, and processes are of the legislation. It also allows for clear interpretation of the legislation by review authorities and subjects to review, as well as in the case of appeals, where applicable. Often, definitions will also establish jurisdiction and the applicability of the screening mechanism.

EXAMPLE 9: TURKEY'S FDI SCREENING REGULATORY DEFINITIONS

Article II of Turkey's Foreign Direct Investment Law defines the following terms:

"A. Foreign investor:

1. Real persons who possess foreign nationality and Turkish nationals resident abroad, and
2. Foreign legal entities established under the laws of foreign countries and international institutions, who make foreign direct investment in Turkey.

B. Foreign direct investment:

1. Establishing a new company or branch of a foreign company by foreign investor,
2. Share acquisitions of a company established in Turkey (any percentage of shares acquired outside the stock exchange or 10 percent or more of the shares or voting power of a company acquired through the stock exchange) by means of, but not limited to the following economic assets:

   i. Assets acquired from abroad by the foreign investor:

   - Capital in cash in the form of convertible currency bought and sold by the Central Bank of the Republic of Turkey,

- Stocks and bonds of foreign companies (excluding government bonds),
- Machinery and equipment,
- Industrial and intellectual property rights;

ii. Assets acquired from Turkey by foreign investor:

- Reinvested earnings, revenues, financial claims, or any other investment-related rights of financial value,
- Commercial rights for the exploration and extraction of natural resources."[11]

5.3.6 MITIGATION AGREEMENTS

Mitigation agreements refer to the set of arrangements, undertakings, and/or conditions between authorities and parties to a transaction that can remediate any concerns with the transaction. These can also be referred to as remedies. Examples of mitigation measures can include:

- Requiring companies to establish access controls for access to certain technology, systems, facilities, or sensitive information.
- Requiring assurances of continuity of supply to the home government for defined periods as well as notification and consultation prior to taking certain business decisions.
- Requiring implementation of security protocols to ensure the integrity of products and software sold to the home government.
- Ensuring that certain facilities, equipment, and operations are located only in the home country.
- Excluding certain sensitive home country assets from the transaction.
- Prohibiting or limiting the transfer or sharing of certain intellectual property, trade secrets, or technical information.

In certain cases, authorities may not wish to prohibit the transaction from taking place and prefer to allow it conditional to such a mitigation agreement being in place. In some jurisdictions, authorities allow for investors to propose remedies; in addition, per the principle of proportionality, authorities should impose the least restrictive measure that still protects the national interest. Discussions between public authorities and transaction parties are typically an important element of reaching mitigation agreements. Mitigation agreements should not impose significant requirements on the seller to continue to provide service or support.

5.3.7 MONITORING COMPLIANCE WITH MITIGATION AGREEMENTS

If a transaction moves forward with a monitoring agreement, it is essential to have techniques and processes in place to monitor compliance. Ideally, written processes, regularly updated, should guide

the implementation of these agreements with components such as checklists, site visit procedures, and the use of third parties to monitor compliance. Each type of monitoring technique should be tied to the specific risk it is meant to mitigate. Monitoring techniques can include, for example:

- Requiring companies to hire compliance personnel such as security officers; these personnel also may serve as points of contact for the monitoring authority.
- Site visits that allow the monitoring authority to access and inspect the company's facilities, technology systems, and documentation.
- Require periodic interviews with company personnel.
- Require company to implement policies and procedures, such as cybersecurity policies, visitor policies, and communication policies.
- Impose third-party periodic audits and monitoring to ensure the company's compliance with the mitigation agreement in place.

EXAMPLE 10: UNITED STATES PRACTICES AND PROCEDURES FOR MONITORING COMPLIANCE WITH MITIGATION AGREEMENTS

Member agencies of the Committee on Foreign Investments in the United States (CFIUS) have adopted several practices and procedures to monitor compliance with measures within mitigation agreements.[12] The Department of Treasury, who chairs CFIUS, has designated at least one U.S. government agency as a lead agency for monitoring compliance with mitigation agreement conditions and measures. The designated lead agency is also in charge of reporting back to CFIUS on the status of compliance. Some of the practices and procedures to monitor compliance in the U.S. include:

- Periodic reporting to the U.S. government agency by companies
- On-site compliance reviews by government agencies that take place on-site
- Third-party audits when provided for in the mitigation agreement
- Investigations and remedial measures if anomalies or breaches are discovered or suspected.

Additionally, agencies charged with monitoring mitigation agreements in the U.S. have also adopted several internal policies, including assigning staff responsibilities for monitoring, using tracking systems to monitor reports, and developing internal systems to ensure that in-house expertise is used and applied for monitoring.

5.3.8 ENFORCEMENT

Any FDI screening system must also ensure that enforcement actions are in place in cases of noncompliance with FDI screening that can allow for the capacity to determine if a violation has occurred, procedures and processes in cases of identified violations, and apply remediation plans or penalties. Enforcement processes should be documented and clear regarding various agencies' roles, information-sharing, criteria for when enforcement is required, and coordination among involved agencies.

5.3.9 PENALTIES

Because of the complexity of FDI screening regulations, especially considering that reviews may take place according to specific criteria and thresholds that can differ from sector to sector, it is important for authorities to clearly state the penalties for non-compliance, as well as the exact situations when these sanctions are imposed. Examples of cases where sanctions can apply are:

- In countries that have a standstill provision, penalties are imposed if the transaction is closed before the review period ends.
- If parties to a transaction do not file even though they are obligated by the regulation to do so. Penalties may apply differently depending on the obligation (filing vs. notice).
- If parties to a transaction are found in non-compliance with mitigation agreements
- In countries where reviews are conducted retroactively.

Different kinds of penalties can be imposed based on the nature of the violation; for a list, please see section 4.2.12.

EXAMPLE 11: PENALTIES IN GERMANY

The German rules on foreign direct investment (FDI) are set out in the German Foreign Trade and Payments Act and the German Foreign Trade and Payments Ordinance, with the Federal Ministry for Economic Affairs and Climate Action (BMWK) as the competent authority for implementation with the involvement of other ministries and government agencies. With the objective of safeguarding public order or security, the BMWK may, in accordance with other ministries, prohibit transactions or issue mitigation measures or remedies.

Breaches of a standstill obligation or order of the BMWK are subject to criminal penalties, including imprisonment of up to five years or criminal fines. Negligent violations are considered an administrative offense, punishable by an administrative fine of up to €500,000.[13]

5.3.10 REMEDIATION PLANS

Remediation plans establish measures to prevent the recurrence of violations with mitigation agreements, especially in the case of minor or technical ones. Instead of imposing penalties, remediation plans can be used to strengthen compliance when the violations are not significant enough to warrant more significant action or can be used as a first step to address the risks of the transaction brought about by the violation, even if authorities are simultaneously considering imposing potential penalties.

5.3.11 ANNUAL REPORTS

Publication of individual transaction screening decisions is generally considered too sensitive and confidential; therefore, governments keep that information classified. However, publication of procedures, trends, patterns, statistics, and other information on an FDI screening system in an open source annual report is a good practice increasingly adopted by countries, and with multiple benefits.

Annual reports provide transparency and accountability for government authorities while also providing investors and potential investors information that can give them confidence regarding planned transactions, as well as important knowledge of procedural details and expectations. This kind of transparency can further have the effect of attracting FDI, because investors are more likely to invest in a transparent and predictable climate. Typically, annual reports can contain the following information, but countries may offer whatever kind of information they see as valuable to readers:

- Figures and trends; for example, reports can provide visuals and explanations of screening and consultations, number and types of screenings undertaken, country and/or region of origin of screened investors, type of screened investors, screened and consulted investments by sector, general trends, approvals/prohibited/conditioned transactions, time taken to review transactions, and more;
- Legislative developments, if any;
- Appeals, compliance, and enforcement;
- Screening activities;
- Cooperation with domestic and international partners;
- Frequently asked questions (FAQs).

5.3.12 STAGES/PHASES OF SCREENING

Countries can implement different phases of screening and review of transactions, allowing for a broad net to be cast and more information to be requested in certain situations. The benefits of this feature are to streamline the review process and make it more efficient. In countries that use stages or phases related to FDI screening, investors interact with or provide information to authorities in certain phases. For example, at an initial phase, investors will submit certain mandatory information. If authorities, based on that information, decide that they wish to close the review process, the transaction will go forward

and no further action is required. However, if the authorities decide that the review should move to a next phase, they will inform the parties and request more information. Further phases can be established according to each countries' process.

EXAMPLE 12: BELGIUM'S SCREENING PHASES

In Belgium, foreign investors must notify Belgium's Interfederal Screening Committee (ISC) if their transactions meet the criteria within the FDI screening regime.[14] In this case, the transaction enters an Assessment phase, whereby the notification is shared with the ISC. If the ISC finds that the transaction may pose a risk for public order, national security or strategic interest, the transaction moves to a Screening phase. The ISC has 30 days from receiving the notification to complete its process in the Assessment Phase.

If the file moves to the Screening phase, the ISC will share its advice and decision with the foreign investor and the Belgian companies that are involved in the transaction. The parties will be granted access to the file and can submit written observations on the file and request a hearing. Thereafter, the notifying parties can enter into negotiations with the ISC in order to agree on corrective measures in order to alleviate the concerns as to the potential risks posed by the transaction. At the end of the screening phase, the ISC can decide to approve the transaction, approve it with conditions or commitments, or prohibit the transaction.

5.3.13 APPEAL MECHANISM

In some countries, if parties to a transaction do not agree with a decision regarding their transaction mandated by a country's FDI screening competent authority, there can be a judicial mechanism in place through which they can appeal the decision. In countries where an appeal mechanism exists, it is good practice to disallow third parties to appeal FDI screening decisions to prevent competitors from undercutting each other against the public interest.

5.3.14 ADVANCE CONSULTATION/PRE-SCREENING

Many countries allow FDI transaction parties to apply for informal, confidential interpretations from the FDI screening authority. In these cases, parties may ask the competent authority for input and guidance, although the authority has no obligation to respond and interpretations will not have a binding effect. Countries may decide to only encourage such advance consultations for complex cases, or in general for any case where such an inquiry could be useful to the parties. It is good practice to provide information about the procedure for advance consultation, such as the types of questions that can be asked, the information that should be provided to the authority, and who to contact, and the form of contact. In some rare cases, countries ask for a fee for providing this service.

Some countries, in lieu of an information advance consultation, have a pre-screening procedure that not a formal review but that can provide helpful information to transaction parties in a more structured way. For example, pre-screening can provide parties to a transaction with information regarding whether their transaction is covered or not by the criteria that establish the need to formally file for screening, and other information.

5.3.15 REQUIREMENT OF POST-INVESTMENT REPORT

In some countries, a post-closing report must be submitted to an FDI screening authority after a set period of time after the screened transaction has been completed and in certain other cases, such as after if it is not exempted from any review. If such a report is mandatory but not submitted, a penalty can be levied.

EXAMPLE 13: JAPAN'S POST-INVESTMENT REPORT REQUIREMENT

According to Japan's Foreign Exchange and Foreign Trade Act, post-investment reports are required when the foreign investor's total shareholding reaches:

i. 1% for the first time1/;
ii. 3% for the first time1/; and
iii. 10% or more for each transaction (as has been the case before the amendment).

Post-investment reports must be submitted within 45 days from the transaction settlement date.

5.3.16 CONFIDENTIALITY

Confidentiality is an important principle in FDI screening regimes and vital to building trust and confidence with the part of the private sector. Confidentiality means that commercial information regarding transactions is protected from disclosure. This includes information submitted by a foreign direct investor related to a filing or even the fact that a transaction by certain parties is under investigation by that country's FDI screening regulation. Civil servants are under the obligations of professional secrecy and generally come under regulations regarding this. In addition, because of the confidential nature of information connected to FDI reviews, some decisions at certain points in the process are not published and third parties cannot have access to it. Parties should always know which authorities of the government will have access to their information, with whom, when, what, and how it will be shared, and how it will be protected from potential public release.

Confidentiality is vital to the strength of an FDI screening process because potential parties to a transaction must know that their information will be protected from competitors or other parties; otherwise, they will be deterred from complying the regulation and filing. Because of this, confidentiality is an incentive for compliance with the FDI screening regime.

5.3.17 NON-PARTIALITY

Screening bodies require protection from political influence. There is always a risk that FDI screening can be used for political ends, such as to engage in economic protectionism. Efforts should be made to ensure that there are processes in place to mitigate the risk of such political influence, which can delegitimize the process, weaken trust from investors, and lead to negative economic and political outcomes.

5.3.18 TRANSLATION

Translating national FDI screening regulations and relevant information and forms into different languages can be beneficial for several reasons. First, translation into the languages of countries where potential large FDI may enter the home country can ensure that transaction parties are aware of their compliance responsibilities with any potential filings. Second, translation contributes to global transparency and international understanding of national systems.

5.3.19 RISK ASSESSMENTS AND RISKED-BASED REVIEWS

Risks to national defense and security or other national FDI screening objectives evolve and transform, sometimes rapidly. Because of the fast-moving nature of risks, especially in areas like sensitive technologies or critical infrastructure, risk assessment should play an important role in the effective implementation of an FDI screening regime. This means, in practice, risk assessments should guide the review of sectors, criteria, thresholds, and definitions to best balance attracting FDI with mitigating risks. In addition, risk assessments should be used in the decision-making process for individual transactions reviews in order to accurately assess any potential threats to the national interest.

5.3.20 UPDATING REGULATIONS AND IMPLEMENTATION PRACTICES

In line with risk-assessment outcomes, geopolitical considerations, and evolving national interests and priorities, regular reviews and updates of FDI screening systems ensures that countries stay ahead of potential risks and threats. There is no minimum amount of time before which countries can implement reforms, and they can be done on a regular periodic basis or on an ad hoc basis. This process also implicitly means that there is a learning process involved in evaluating the strengths and weaknesses of a system and that lesson learned can be incorporated into strengthening the system. These updates usually involve on the one hand, changes to national regulations, such as scope, procedures, criteria & thresholds, sanctions, or other elements, as well as implementation practices such as incorporating any of the practices listed in this section. Involving public opinion may be a helpful exercise in updating regulations and receiving important feedback.

5.3.21 OUTREACH AND PUBLIC-PRIVATE CONSULTATION

Government authorities responsible for FDI screening regulations and implementation should regularly consult with the private sector for several reasons. First, it is important for the private sector to be made aware of potential FDI screening obligations and responsibilities so that they can be compliant in the case where transactions they are party to fall under the screening regime. While it is each parties' responsibility to be compliant with regulations, compliance can be affected by awareness-raising and outreach to relevant sectors. There are multiple strategies that public authorities can pursue outreach, and strategies can also be adopted or merged with outreach for other regulatory spheres such as export controls. Second, the private sector can provide government authorities with valuable information regarding trends in technology, risks to specific sectors, inquiries and trends regarding foreign investment activity, and risks and benefits of specific FDI screening policies. Building different lines of communication and trust with the private sector can provide the structural foundation for a successful FDI screening regime.

Outreach to the private sector can take place in the following (non-exhaustive) ways: websites, newsletters, informational pamphlets, guides/manuals, annual reports, outreach/informational events, conferences, webinars, advisory committees with private participation, and requests for private sector perspectives on FDI screening-related policies.

5.3.22 IMPACT ASSESSMENTS

Impact assessments are important for policy-making broadly and can be especially valuable when considering the potential impacts of FDI screening on national economies. Impact assessment specifically refers to having "a systemic approach to critically assessing the positive and negative effects of proposed and existing regulations and non-regulatory alternatives."[15] Impact assessments can contribute to maximizing regulatory efficiency and effectiveness.

5.3.23 EXPERT INPUT IN POLICY-MAKING

The expertise and knowledge represented by policy-makers plays an important role in the ultimate quality and effectiveness of regulations and their implementation. Governments may invite certain agencies with specialized knowledge or perhaps outside experts for consultations. In the context of FDI screening, having the right minds around the table is part of the recipe, along with other good practices, for a regime that is able to attract quality FDI and mitigate national security risks. It is important to know what kind of expertise is required for drafting or strengthening FDI screening legislation and processes: for example, from the legal, technology, trade, economics, defense, as well as other policy spheres.

5.3.24 ADEQUATE RESOURCES FOR COMPETENT AUTHORITIES

Authorities and personnel within them in charge of managing the entirety of the FDI screening regime should have adequate resources, including funding, time, personnel, and access to information. Depending on how many transactions are captured under the regime, resources should be periodically reassessed to ensure they match with what is required.

5.3.25 INFORMATION EXCHANGE WITH FOREIGN COUNTERPARTS

International communication, cooperation, and information exchange is still relatively nascent in the area of FDI screening. Information sharing can include sharing experience, best practices and information on issues of common concern. This practice is important in order to identify trends and risks in FDI, especially if there are specific concerns regarding certain countries of investment origin or certain targeted sectors for investment. In addition, because FDI screening systems vary so significantly, communication and understanding of different systems can be a useful way of considering the benefits and drawbacks of system features and how they can apply to one's own country.

5.3.26 GUIDANCE ON HOW TO FILE AND FILL OUT FORMS

Government authorities have an interest in making the filing process as efficient and effective as possible for covered transactions in order to maximize resources and ensure that they receive the most accurate and complete information possible in order to make their decision. Providing parties with guidance on how complete and file (or register) forms can aid in this process. This guidance can provide parties with information on how to classify their transaction, tips for filling out specific sections, checklists, information on what additional documents must be provided with the form and how they should be submitted, and even examples.

EXAMPLE 14: UNITED KINGDOM'S WEBSITE GUIDANCE

The United Kingdom's website on "National Security and Investment notification service" contains a dedicated section for "mandatory, voluntary, and retrospective forms."[16] This useful page contains information on the following for potential form-filers:

- Data classification: due to the confidential nature of information submitted as part of the screening review process, the page provides guidance on what steps to take to protect the information.
- Registration information for the online portal through which the form is submitted
- Who can officially submit the form
- Tips for completing forms (e.g., who should provide signatures, formats for submission, etc.)
- Detailed examples for specific scenarios, including when acquisitions within a set of linked acquisitions are notifiable and others are not; the acquisition of multiple qualifying entities or assets from the same seller to a single acquirer; the internal restructuring of an entity where there is no overall change in ultimate ownership; and the acquisition of multiple qualifying entities or assets involving the same acquirer(s) but different sellers/parents.

- How to provide relevant information about the acquirer, the acquisition, the sector, and key dates
- How to provide information about qualifying entity and qualifying asset details, such as UK Government Security Classification, licenses, dual-use items, supply relationships, R&D, vetting clearance, ownership and structure of the qualifying entity
- How to provide information about the acquirer and details to include
- What kinds of declarations to provide, and,
- Other useful information, such as how to withdraw or delete a notification.

5.3.27 TECHNICAL REACHBACK

Different competences are necessary to adequately review FDI transactions that may pose a concern. As described in section 5.3.24, "Adequate Resources for Competent Authorities," having resources to staff the government bodies responsible for the FDI screening process means also assuring that there is technical competence to assess transactions. The ability to rely on a network of technical experts for input is important because the nature of transactions can be varied and especially challenging when assessing, for example, security risks of FDI transactions involving sensitive technology sectors. Whether its seeking technical expertise from individuals in various relevant agencies, or having trusted private sector consultants, or both, countries must consider how to ensure they have adequate network of expertise in place to support efficient and effective FDI screening processes.

5.3.28 LONG-TERM STRATEGIC VISION

What kind of national FDI screening system a country chooses to implement should be based, in addition to short- or medium-term goals, on a long-term strategic vision—one that considers what the country desires for its citizens, where it sees its place in the global playing field, and how FDI can affect that. FDI can contribute to growth and development, while the screening mechanism can be tailored and calibrated to a country's own threat and risk perception. A country can review its screening system against those long-term goals and use them as guideposts for how policies and implementation should take place.

6. Summary, Key Takeaways, and Perspectives on the Future

In a globalized world full of connections and dependencies between countries, foreign direct investment provides the fuel for growth and progress. Access to the capital, skills, and technology that FDI renders makes the world a better place. However, while it is important for countries to attract FDI through open investment policies, it is just as important to account for risks that certain FDI transactions can create. As each country has different perceptions of risk as well as their own priorities regarding national security, the way to manage these challenges will differ and ultimately mirror those country-specific nuances. One certainty is that the need for astute and well-calibrated national FDI screening systems is only going to become more important, especially as new risks emerge due to technological developments and continuing foreign policy challenges.

This FDI Screening Primer document has presented the context, frameworks, objectives, measures, guidelines, and good practices involved in FDI screening to provide national authorities, as well as other FDI stakeholders, a toolbox for building, strengthening, or expanding FDI screening systems so that they are fit for purpose and match national objectives. As time goes on, new practices will emerge that can be added to what is contained in this document, and countries will constantly be reassessing and recalibrating to ensure that systems match needs. The fluidity and fast-changing nature of the risk landscape that guides many FDI screening systems is one of the key and defining aspects of this policy area. Because of this reality, governments need to ensure that they have a way of identifying what both their needs—as well as long-term vision—is for the contribution of FDI to their national economies and societies.

One of the challenges of such a quickly developing and often sensitive policy area is that there are no international organizations or multilateral structures that countries—regardless of their GDP, FDI profile, or geographic location—can turn to for authoritative guidance, training, or consultation on this important topic. The individualized nature of national priorities guiding FDI screening can mitigate the utility of prescriptive guidelines. For this reason, identifying good practices—practices that may work in some contexts but may not be appropriate in others—is a useful way forward in thinking through ways to build capacity in a meaningful way. In addition, regional frameworks that provide opportunities for some common ground as well as consultation and information sharing—such as the European Union FDI screening framework—may be a useful way forward if applied in other regions. Finally, the important role of civil society—the private sector, research organizations, and academia—in bringing together expertise and building networks of practice will prove integral in the aim of finding the right balance between the benefits and risks of FDI.

7. Further Resources

- Organization for Economic Cooperation and Development (OECD) Investment Policies Related to National Security and Public Order, https://www.oecd.org/investment/investment-policy-national-security.htm
- United Nations Conference on Trade and Development (UNCTAD)
- International Bar Association, https://www.ibanet.org/
- CFIUS Investment Compliance Guidelines
- Congressional Research Service reports, https://sgp.fas.org/crs/row/index.html

Endnotes

[1] While no authoritative international legal definition exists for FDI screening, this Primer uses a broad definition from the EU FDI Regulation, which appropriately covers the many aspects within the term.

[2] "Foreign Direct Investment," Organization for Economic Cooperation and Development, <https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-en#:~:text=Foreign%20direct%20investment%20(FDI)%20is,enterprise%20resident%20in%20another%20economy>.

[3] United States, H.R.584, Foreign Investment Risk Review Modernization Act of 2018, <https://www.congress.gov/bill/115th-congress/house-bill/5841/text>.

[4] Japan, Foreign Exchange and Foreign Trade Act, Act No. 228 of December 1, 1949, <https://www.cas.go.jp/jp/seisaku/hourei/data/FTA.pdf>.

[5] Denmark, Act on Screening of Certain Foreign Direct Investments in Denmark (the Investment Screening Act), May 11, 2021, Ministry of Business, Industry, and Financial Affairs, <https://assets.ctfassets.net/kunz2thx8mib/12NNUnRR36F4tb239ipRlp/d938e94df980165ae561e5c792d8fdf1/Act_on_screening_of_certain_foreign_direct_investments__etc._in_Denmark__the_Investment_Screening_Act_.pdf>.

[6] Malta, Notification Form, <https://applicationform.nfdismalta.com>.

[7] Regulation (EU) 2019/452 of the European Parliament and the Council of 19 March 2019 Establishing a Framework for the Screening of Foreign Direct Investments into the Union," March 19, 2019, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0452>.

[8] Regulation of the European Parliament and the Council on the Screening of Foreign Direct Investments in the Union and Repealing Regulation (EU) 2019/452 of the European Parliament and of the Council," January 24, 2024.

[9] Organization for Economic Cooperation and Development (OECD), "Recommendations on Guidelines for Recipient Country Investment Policies relating to National Security," OECD/Legal/0372, <https://legalinstruments.oecd.org/public/doc/227/227.en.pdf>.

[10] Australia, Foreign Acquisitions and Takeovers Fees Imposition Act of 2015, Federal Register of Legislation, No. 152, 2015, <https://www.legislation.gov.au/C2015A00152/2021-01-01/text>.

[11] Foreign Direct Investment Law, Official Gazette, Turkiye, June 17, 2003.

[12] Committee on Foreign Investments in the United States (CFIUS), Annual Report to Congress, CY 2022, < https://home.treasury.gov/system/files/206/CFIUS%20-%20Annual%20Report%20to%20Congress%20CY%202022_0.pdf>.

[13] Germany's Foreign Trade and Payments Act, Federal Ministry of Justice, May 23, 2022, <https://www.gesetze-im-internet.de/englisch_awg/englisch_awg.html>; Germany's Foreign Trade and Payment Ordinance, Federal Ministry of Justice, April 25, 2022, <https://www.gesetze-im-internet.de/englisch_awv/>.

[14] Interfederale Screeningscommissie, Belgium Ministry of Economy, <https://economie.fgov.be/nl/themas/handelsbeleid/interfederale>.

[15] "Regulatory Impact Assessment," OECD, <https://www.oecd.org/gov/regulatory-policy/ria.htm#:~:text=Regulatory%20impact%20assessment%20(RIA)%20is,regulations%20and%20non%2Dregulatory%20alternatives>.

[16] United Kingdom, Guidance on Completing and Registering a Notification Form, February 18, 2024, <https://www.gov.uk/government/publications/national-security-and-investment-notification-service-mandatory-voluntary-and-retrospective-forms/guidance-on-completing-and-registering-a-notification-form>.

The Stimson Center promotes international security and shared prosperity through applied research and independent analysis, global engagement, and policy innovation.

STIMSON.ORG

© Henry L. Stimson Center

STIMSON

INNOVATIVE IDEAS CHANGING THE WORLD