COVID-19 Brings Renewed Concerns Over Foreign Direct Investments

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Late 2018 into early 2019, there was increasing attention put on foreign direct investment in sensitive sectors by several major jurisdictions. At that time, the driver for this focus was a volatile political landscape stemming from the breakdown of trade between the US and China, as well as uncertainty of the US' involvement in NATO and Russia's continued meddling in foreign elections. The focus then was on foreign entities acquiring strategic technologies, critical infrastructure and communications.

Back then, Germany, France, and even the United States announced changes to their regulatory regime as it relates to direct foreign investment. Germany announced a lowering of its threshold from 25% to 10% in critical infrastructure and media businesses. On the same day, France extended its current foreign investment restrictions to include space, IT for police and custom services, data hosting and R&D in cybersecurity, robotics, AI, semiconductors, and dual use goods.

In response to the Foreign Investment Risk Review Modernization Act which became law in August 2018, the U.S. launched a pilot program to review foreign investment during 2019 and finalized these rules earlier this year.

Now with the COVID-19 pandemic, governments are once again reviewing the foreign direct investment in sensitive sectors

While everyone focused on continued containment of COVID-19 and more importantly a vaccine, regulatory focus once again has shifted to sensitive sectors. As the world panicked for PPE (personal protective equipment) and life-saving medical equipment, regulators worried about foreign direct investment into these sensitive sectors. The E.U. issued guidance on "protection of Europe's strategic assets" on 25 March and E.U. countries are issuing their support for the E.U. guidelines for foreign direct investment (FDI) screening. Most recently, Sweden issued support and compliance with the E.U. guidelines but France went further by lowering the threshold in sensitive sector issuers to 10%. This temporary reporting threshold will trigger their authorization procedure. This temporary threshold is expected to last until the end of 2020.

Elsewhere, Australia has issued their most comprehensive reforms in this area in more than 20 years. The government is expected to release draft legislation soon. Japan issued similar screening guidelines for inward direct investment and specified acquisition under the Foreign

Exchange and Foreign Trade Act (FEFTA). The guidelines include 12 screening factors that consider the foreign investor profile and the impact of the investment on the Japanese economy. Here are three of the screening factors:

1. Attributes of the foreign investor including its capital structure, beneficial ownership and business relationships;
2. The degree of impact on protection of national security, maintenance of public order, safeguard of public safety; and
3. The possibility of leakage of technologies or information and the use of those technologies or information against the objectives of protection of national security, maintenance of public order, or safeguard of public safety.

Following up on the implementation of these FDI screening rules, on 6 March 2020 the US blocked China from acquiring StayNTouch an hotel management software company. The White House citing a threat to the national security of the US. This decision requires divestment of all interest from the China based company Beijing Shiji.

If you are an asset management firm investing in sensitive sectors, it would be best to review the FDI screening rules in the jurisdiction that you are investing in before taking any substantial position. It might just save you some headaches down the road.