A PERSPECTIVE ON THE PROLIFERATION OF FDI SCREENING REGIMES ACROSS JURISDICTIONS

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The UNCTAD's World Investment Report 2021 indicated that in 2020, 67 countries adopted policy measures related to foreign investment, most of which took place in developed economies, largely as a response to the pandemic and mainly restrictive.[1] The report noted that the number of restrictive policy measures in reaction to the pandemic superseded those that were adopted during the financial crisis 2007-2009.[2] It also outlined that even if the vast majority of FDI measures have been generally adopted by developed economies (81 per cent), an important number of developing and emerging economies are mirroring the movement.[3] The types of measures vary from country to country: some are temporary and others are permanent, some have lowered the thresholds that trigger intervention, some have expanded the prior approval requirements for FDI, and others have established strategic sectors where the special power regime is applied strictly.[4]

This paper will concisely present the FDI screening regime in the UK as well as discuss the respective regimes in South Africa, India, Russia and Japan.

The FDI screening regime in the UK

In the UK, traditionally there was no standalone foreign investment screening regime but the powers to assess national security considerations were provided for in the

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[1] United Nations Conference on Trade and Development – UNCTAD, "World Investment Report 2021," p. 109, available at https://unctad.org/system/files/official-document/wir2021_en.pdf (Last visited 8 April 2022).

[2] United Nations Conference on Trade and Development – UNCTAD, "World Investment Report 2021," p. 109, available at https://unctad.org/system/files/official-document/wir2021_en.pdf (Last visited 8 April 2022).

[3] United Nations Conference on Trade and Development – UNCTAD, "World Investment Report 2021," p. 109 and 111, available at https://unctad.org/system/files/official-document/wir2021_en.pdf (Last visited 8 April 2022).

[4] Please see the summary of the measures in United Nations Conference on Trade and Development – UNCTAD, "World Investment Report 2021," p. 111-113, available at https://unctad.org/system/files/official-document/wir2021_en.pdf (Last visited 8 April 2022).

public interest test of the Enterprise Act 2002. The Government's powers to intervene in foreign investment are primarily founded upon the national merger control regime and supplemented by specific sector regulations. In October 2017, the Government published the National Security and Infrastructure Investment Green Paper ("Green Paper"), reviewing the national security implications arising from foreign investment and control. The Green Paper introduced a set of short and long-term proposals to reform and strengthen its powers to scrutinise these national security implications of foreign investment.[5]

The first consultation focused on the short-term proposals that resulted in the first significant amendments to the UK merger control regime since the Enterprise Act 2002 came into force.[6] The second consultation set out broad options for longer-term, more far-reaching reforms. This was followed by the National Security and Investment White Paper in July 2018, which set out even more detailed proposals. These far-reaching reforms were later brought forward by the National Security and Investment Bill, which will be discussed in detail below. Additional short-term measures were later added by way of two statutory instruments[7] as a way of mitigating urgent risks pending the implementation of more comprehensive powers in the forthcoming new FDI regime in the UK.[8]

The UK National Security and Investment Act

The UK Government brought the Bill on National Security and Investment Strategy ("NSI Bill") before the UK Parliament in November 2020. On 5 May 2021, the National Security and Investment Act 2021 ("NSI Act") was published, after receiving Royal Asset on 29 April 2021. The NSI Act is expected to enter into force towards the end of 2021, while parts of the regime, such as the Secretary of State's "call-in powers" will be applicable to transactions that are completed even before that time.

The NSI Act launches an investment screening regime based on national security criteria, separate from the existing merger screening by the CMA. The existing regime under the Enterprise Act 2002 will continue to run in parallel, with the CMA remaining the competent authority for competition law purposes only. Therefore, when the new regime is implemented, the national security considerations will effectively be removed from the public interest and special public interest regimes under the Enterprise Act 2002. However, the Government's statutory powers to intervene in investments for the purposes of protecting media plurality, financial stability and public health emergency will be preserved.

Whereas the scope of the Enterprise Act 2002 is largely defined by the size of the transaction (through the turnover and share of supply thresholds), the new national security screening system rather focuses on the means by which an investor could acquire the ability to undermine national security. The UK Government will be able to scrutinise, impose conditions on or, as a last resort, block a deal if it is concluded that there is an unacceptable risk to Britain's national security.

Principal features of the new regime include:

i. the establishment of a dedicated governmental unit,

ii. a mandatory notification and pre-approval system for transactions in specific sectors of the economy,

iii. a voluntary notification system available to investors,

iv. "call-in powers" of the Secretary of State for unnotified investments,

v. a specific time limit for intervention

vi. the application of remedies to address risks to national security and sanctions for non-compliance with the regime and

vii. a mechanism for legal challenge of governmental decisions.

The Act provided that mandatory notification will only be required for certain types of transactions in seventeen (17) key sectors, which are regarded as being the most sensitive areas of the economy based on their susceptibility to national security threats.

[5] National Security and Infrastructure Review: The Government's review of national security implications of foreign ownership or control, October 2017 available at
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/652505/2017_10_16_NSII_Green_Paper_final.pdf
[6] The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 and the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018, which came into force on 11 June 2018.
[7] Enterprise Act 2002 by the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2020 and the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2020.
[8] See Press release from the Department for Business, Energy & Industrial Strategy and The Rt Hon Alok Sharma MP, titled "New protections for UK businesses key to national security and fight against coronavirus" and published on 21 June 2020, available at https://www.gov.uk/government/news/new-protections-for-uk-businesses-key-to-national-security-and-fight-against-coronavirus.

These sectors are as follows:

- advanced materials
- advanced robotics
- artificial intelligence
- civil nuclear
- communications
- computing hardware
- critical suppliers to Government
- critical suppliers to the emergency services
- cryptographic authentication
- data infrastructure
- defence
- energy
- synthetic biology
- military and dual use
- quantum technologies
- satellite and space technologies
- and transport.

If a transaction falls within one of the specified sectors, it will be subject to a mandatory notification obligation, if it involves one of the specified 'trigger events':

a. the acquirer gains or increases its interest in the entity by virtue of the percentage of the voting rights or shares that the acquirer holds increasing:

- from 25% or less to more than 25%;[9]
- from 50% or less to more than 50%; or
- from less than 75% to 75% or more.[10]

b. the acquirer obtains voting rights in the entity that, whether alone or together with other voting rights held by it, enables it to secure or prevent the passing of any corporate resolution.

Some recent data on the UK regime

A recent Report[11] on the FDI screening regime shows that there were 222 notifications received in the period 4th January 2022 – 31st March 2022. This number is indicative of the number of notifications BEIS expects on an annual basis, between 1200-1800.

The total number of mandatory notifications received	196
The total number of voluntary notifications received	25
The total number of retrospective validation applications received	1

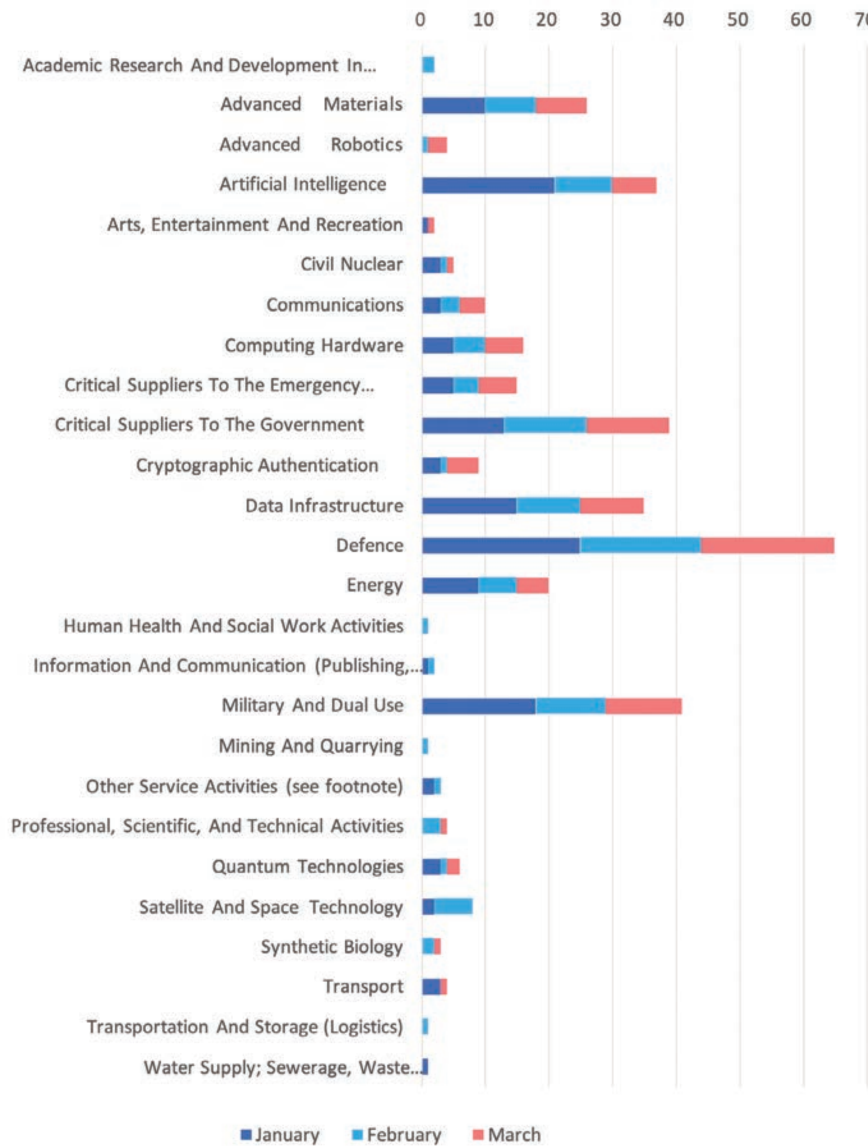
The number of notifications received is slightly less than the number of qualifying acquisitions that have been notified. This is because in rare cases the Government has accepted a single notification to cover multiple qualifying acquisitions.

A total of 209 notifications have been accepted or rejected in the reporting period, of the total 222 notifications received in the same period. The difference is because 13 notifications were still being evaluated at the end of the reporting period.

The number of mandatory notifications accepted	178
The number of voluntary notifications accepted	22
The number of mandatory notifications rejected	7
The number of voluntary notifications rejected	1
The number of retrospective validation applications accepted	1
The number of retrospective validation applications rejected	0

[9] In an earlier iteration of the Bill, before it became an Act, the acquisition of a right or interest crossing a threshold of 15% in a qualifying entity would be a "notifiable acquisition" – not a "trigger event" in itself, but one which must be notified so that an assessment could be made of whether there was a trigger event. However, this 15% threshold was removed from the Bill shortly before it received Royal Assent, so transactions at this level do not require mandatory notification under the Act. It has been commented that this change was prompted by a concern that the threshold was disproportionate, noting that similar mandatory notification systems, for example under the US CFIUS regime, use the threshold of 25% as a starting point.
[10] Notably, this is in line with the figures used by the CMA when assessing whether a merger may raise competition concerns.
[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1083295/E02757792-nsi-annual-report-2022.pdf.

The following figure shows the areas of the economy in which notifications were accepted and rejected (including both mandatory and voluntary) each month. Each notification can be associated with more than one area, hence the total number of notifications associated with each area is higher than the total number of notifications.



It is noteworthy that so far, no transactions have been blocked under the new FDI screening regime.

The FDI screening regimes in South Africa, India, Russia and Japan

As part of the global proliferation of FDI screening regimes, we will briefly discuss the measures that have been adopted in Russia, Japan, India, and South Africa.

In Russia, the adoption of extensive FDI rules has been crucial to protect not just its commanding position in the strategic natural resources industry, Russian's main source of hard currency, but in any other sector. The economic sanctions imposed on Russia after its invasion to Ukraine have elicited the adoption of stricter FDI rules targeting those countries who have deployed them.

Like Russia, India has also developed new foreign rules to target land border countries more precisely. The threat posed by opportunistic takeovers during the COVID-19 pandemic induced the adoption of some measures aimed at protecting the domestic industries from the intervention of geopolitical rivals, including the dominant Chinese. Unlike Russia, since India adopted its "Open door Policy" in 1991, foreign participation has been welcomed and the government has portrayed as comfortable with globalisation, at least in theory. In practice, this notion is overshadowed by a sense of disappointment once firms

need to navigate a set of complex specific-sector restrictions and multiple authorities with shared jurisdiction. In its efforts to encourage foreign investments, the Indian government has created a screening mechanism. In fact, the opposite is more likely. Under the new screening mechanism, the government enjoys full discretion to decide, it applies national security or national interest considerations ill-defined, applicants are not involved in the review process and, if a proposal is rejected, they Government will not inform the reasons.

Japan also adopted FDI measures to counteract the COVID-19 pandemic. It lowered the threshold for pre-transaction approval from 10% to 1%, designated business sectors as core (e.g., weapons) or non-core (e.g., electricity) according to the degree they affect national security and exempted some from mandatory notification. Although such an exemption is welcome amidst the business community, some concerns persist. Investors need to keep in mind strict filing times and be ready to accept recommendations aimed at addressing national security, public order, public safety, or smooth management of the Japanese economy issues raised by their proposals or abandon them. Nevertheless, the meaning of these issues is uncertain and the whole review process as a result. More worryingly, the adoption of spurious national security concerns without proper oversight can reinforce the resistance that for decades Japan has shown towards foreign investors. In this context, the strategy introduced by the Prime Minister of Japan Abe Shinzo in 2013, and the subsequent reforms seeking to remove the barriers that have impeded high levels of inward FDI, have been put to the test.

The strengthening of FDI rules echoed across South Africa. This is a paradoxical decision considering that after decades of great efforts South Africa has failed to attract investors. Contrary to what we have seen in Russia, India and Japan, whose interventions in foreign takeovers have been crafted to protect their national security, in South Africa the high levels of crime have deterred foreign investors. Now that the pandemic seems to have receded, South African is facing a precarious economic situation with pressing social problems on the rise. Therefore, it comes with no surprise that the South African government has not yet implemented the reform sought to intervene in foreign takeovers on national security grounds in 2018. It seems that the real question for the government now is not whether they can control inward FDI, but at what price. A further question is how to reconcile two policies that clash each other: on one hand, the protection of the legal rights of foreign investors and, on the other, the special protection of the non-white population in the South Africa economy. An extricated complex relationship.

These jurisdictions are pertinent case studies as their unique characteristics offer us the opportunity to provide some reflections. The Russian regime has seen in the FDI rules a right tool to advance it. Like other countries, Japan has expanded the scope of review by lowering the thresholds from 10 per cent to 1 per cent and by including more than 500 companies in 12 industries as relevant to national security. Unlike most jurisdictions, Japan has incorporated some foreign investment screening exemptions. India has crafted its national security measures grounded on land borders. This tactic was devised to protect its companies from opportunistic takeovers during the pandemic. In South Africa, a screening mechanism of foreign investments was introduced in 2018 but is not yet in force. In this context, this chapter suggests that for the business community it is difficult to navigate all these distinctive rules, that foreign investment rules have proven to be reciprocal tools and if applied without sufficient caution, governments are putting the benefits of free markets in peril.