CSIS Review of the Committee on Foreign Investment in the United States

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A Report of the
CSIS INTERNATIONAL SECURITY PROGRAM
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The authors would also like to thank the participants in the working group discussions that were essential in providing context and perspectives against which to assess suggestions and potential courses of actions.

The study effort was undertaken with support from Elbit Systems of America and informed by the perspectives of the working group participants, but the findings and conclusions—and any shortcomings in the report—are solely those of the study authors.
Executive Summary

In the first decade of this century, two large attempted acquisitions of U.S. based operations by foreign-owned companies—one successful the other not—spurred a reexamination of the role of the government in foreign investment in the United States. The first such case, the attempted acquisition of Unocal by China National Offshore Oil Company (CNOOC) a state-owned company of China in 2005, gained public attention and resulted in a number of statements of concern or opposition by political figures. Ultimately, CNOOC dropped its effort to acquire Unocal. In 2006, a firm based in the United Arab Emirates, Dubai Ports World (DPW), sought to acquire a British-owned port-operating firm, Peninsular and Oriental Steam Navigation Company (P&O) that held the contract to operate a number of U.S. ports. In the aftermath of the September 11th attacks, this transaction also garnered a high level of public attention and triggered a call to review the statute and regulations governing the Committee on Foreign Investment in the United States (CFIUS). News of both transactions sparked significant media coverage and expressions of concern from the public to which political leaders responded.

The DPW case spurred a report by the Council on Foreign Relations on the role and impact of CFIUS which provided a number of recommendations to improve the process and to ensure it satisfied Congressional intent and executive obligations. Informed by that report and other sources, Congress passed the Foreign Investment and National Security Act of 2007 (FINSA). FINSA was the first significant legislative reexamination of CFIUS since 1988. Importantly, FINSA maintained CFIUS’s national security mandate, but clarified that the term “national security” included homeland security matters, such as the impact of transactions on critical infrastructure and added the Secretary of Homeland Security as a statutory member of the committee. In addition, FINSA imposed additional Congressional oversight over CFIUS by, among other things, mandating that CFIUS provide certain Congressional committees with reports following conclusion of action on transactions and requiring an annual report to the Congress on the types, sectors, and countries of origin of cases examined by CFIUS. Treasury subsequently issued regulations and guidance to implement FINSA.

Today, the seemingly greater role of cross-border mergers and acquisitions—especially those from China—as well as growing participation in transactions by new players, including private equity firms whose ownership structures frequently provide less readily available information regarding ownership or governance than publicly traded firms, suggested the time was right to examine how well the CFIUS process was functioning under changing conditions. Seven years after the passage of FINSA, CSIS has undertaken a study to examine how well CFIUS was functioning, based on both the available data and drawing on the expertise of stakeholders involved in the process.

This effort has resulted in three main findings:

- First, that CFIUS is working. Based on clear timelines and structure, CFIUS provides the business community with a reasonably predictable process while allowing for a rigorous review by CFIUS member agencies. The voluntary nature of CFIUS contributes to its
success—as firms file to ensure they do not encounter disruptive regulatory intervention later—while enabling the vast majority of cases without security implications to forego CFIUS entirely.

• Second, risks in the process are potentially increasing, and merit continued monitoring. Complex ownership structures of the acquiring firms filing with CFIUS add layers of difficulty and therefore perception of risk. Within the United States and globally, a trend toward increasingly complex ownership structures of acquisition vehicles is emerging. The resulting corporate structures can be complex and require high levels of due diligence to fully understand. Performing sufficient analysis is increasingly time-consuming, and may increase perception of risk by government officials when making national security evaluations.

• Third, there is a need for greater communication, in terms of both outreach and clarification of existing guidance documents.

Based on the findings, the report highlights several recommendations that would improve the functioning of the process, enhance overall understanding of CFIUS, and create the least negative impact across the range of stakeholders. First, an implicit recommendation that bears emphasizing: do no harm. The CFIUS process is working well, and any needed adjustments should be minor.

• Sustain dialogue between government and parties to transactions. Ensuring that government officials have the ability to interact with parties in a timely way will better enable informed decision-making and risk-assessment. Recent improvements in this regard have been welcomed by stakeholders.

• Hold a regular “Industry Day.” Firms from 22 market sectors and sub-sectors have undergone CFIUS review recently. Enhancing awareness of CFIUS’s role and requirements will facilitate better interactions with parties who are not familiar with CFIUS.

• Periodically update CFIUS Guidance. The types of transactions CFIUS reviews and considerations of what constitutes national security have evolved over time. The CFIUS process would be aided by periodically updating the Guidance to better reflect these shifts over time.

• Enhance use of risk-management practices. One way to do this would be to establish clear procedures that deliberately consider long-standing compliance with existing mitigation agreements when evaluating new transactions from a foreign party with a history with CFIUS. Another way to enhance risk-management would be to continue to monitor the growing complexity of cases to ensure the CFIUS community has sufficient personnel and resources to sustain its current case-review rate. In particular, cases that involve multiple layers of limited partnerships and other complex ownership structures require greater time and attention from CFIUS to understand and evaluate.
Background

What CFIUS Is

The Committee on Foreign Investment in the United States is responsible for reviewing the national security implications of certain foreign investments that could result in foreign control of a U.S. business. CFIUS is chaired by the secretary of the treasury, and composed of the heads of the Departments of Justice, Homeland Security, Commerce, Defense, State, Energy, the Office of the U.S. Trade Representative, and the Office of Science and Technology Policy. The director of national intelligence and the secretary of labor serve as nonvoting members of the committee. The heads of additional offices within the executive office of the president also observe proceedings. Filing for CFIUS is ostensibly a voluntary process initiated by parties to a transaction. The committee retains the legal authority, however, to request that parties who do not voluntarily file submit a filing if, in the judgment of the committee, a transaction over which it may have jurisdiction may raise national security considerations. Gaining CFIUS approval of a transaction provides parties to a transaction with certainty that their transaction will not be reopened for review by CFIUS, except in very limited circumstances, such as fraud or misrepresentation.

Established by executive order in 1975 by President Ford, CFIUS’s original charter was to monitor investments in the United States to ensure foreign parties were not able to adversely impact U.S. national security through investments or acquisitions in U.S. firms. At that time, most of the concern was focused on potential investments by firms controlled by the Soviet Union or its allies. CFIUS existed only by executive order until 1988. Prompted by increased Japanese investment in the United States, Congress passed the Exxon-Florio amendment to Section 721 of the Defense Production Act of 1950, which gave the president statutory authority to review and investigate transactions with foreign persons that could affect U.S. national security and prohibit transactions with foreign persons that the president found to be a threat to U.S. national security. President Reagan, in turn, issued an executive order, which delegated part of the president’s authority (the review and investigation function) under the Exxon-Florio amendment to CFIUS. The CFIUS process was further amended when Congress passed FINSA in 2007, its first major legislative adjustment in 30 years.

How CFIUS Works

CFIUS is largely a voluntary process, which means that parties elect to file with CFIUS, although, as noted above, it has the legal authority to request a filing, even after the transaction closes, where one has not otherwise been made and the committee considers that it may raise national security considerations.
In accordance with the CFIUS regulations, parties prepare a joint voluntary notice to be submitted to Treasury as CFIUS Chair. CFIUS regulations encourage the submission of a draft notice approximately five to seven days prior to the formal filing of a notice. Once the CFIUS staff at the Department of the Treasury has “accepted” the notice submission, the review process formally begins. The first phase of the process is a 30-day review period. Treasury uses this time to confirm the completeness of the filing, and establish which agency or agencies within CFIUS should colead with Treasury on the review. During the review, the lead and colead agency assess whether national security risk arises from the transaction. This assessment involves an analysis of three factors: the threat posed by the foreign acquirer; the vulnerability posed by the U.S. business; and the potential consequences of the interaction of those two factors for U.S. national security. The findings of the review are reported back to the full committee. At the end of the 30-day review period, if CFIUS finds no unresolved national security concerns, it will notify the parties that it has concluded action on the case. At the conclusion of the 30-day review period, however, certain transactions may move into an additional 45-day investigation period if additional time or due diligence is required, or if certain statutory presumptions are met. The analysis of whether national security risk arises as a result of the transaction continues during this period.

In the rare event that at the end of the 45-day investigation period CFIUS has been unable to conclude action on the transaction, it will be sent to the president for decision with recommendations from CFIUS. The president then has 15 days to decide whether to take action, including approving, suspending, or prohibiting the transaction (including unwinding it if the transaction is already completed). Should the president not approve the case, he or she must find that there is credible evidence which leads the president to believe that the foreign interest might take action that threatens national security, and that no other provisions of law provide adequate and appropriate authority to protect national security. Only the president has the authority under law to suspend or prohibit a transaction.

In practice, very few cases reviewed by CFIUS reach the president. In most cases, when advised that CFIUS will send a report to the president, and that no mitigation is possible to address an identified national security risk, parties will generally abandon or unwind the transaction rather than force a presidential decision.

Only two cases have been blocked by the president since CFIUS was established. The first was prohibited by President George H.W. Bush in 1990 when he ordered China National Aero-Technology Import and Export Corporation to divest its interest in MAMCO Manufacturing, Inc. The second case was prohibited by President Obama in 2012, when he ordered the unwinding of a purchase of four limited liability companies operating wind farm projects by the Ralls Corporation, a Chinese-owned and controlled company. The properties were located near a U.S. Navy flight testing range.

In both of the cases cited above, the president determined that the transaction under review posed a threat to the national security of the United States and that no other provision of U.S. law would enable the United States to address the identified national security risk.

CFIUS has broad authority to negotiate legally binding mitigation agreements with parties or to impose conditions on parties in order to address any national security risks identified as arising from a transaction. Since 2005, CFIUS has mitigated 87 of the 1,095 transactions reviewed by
CFIUS since 2005. Since the passage of FINSA, mitigation agreements have been applied to approximately 7 percent of cases each year. These mitigation agreements include restricting access to information or facilities to authorized persons, often only U.S. citizens; and providing the U.S. government the right to review and possibly object to certain business decisions that may raise national security concerns.¹

Monitoring compliance with mitigation agreements is assigned to a colead agency of the committee by the Department of Treasury. For example, if the Department of Homeland Security (DHS) is the colead with Treasury on a case involving the potential acquisition of critical U.S. infrastructure, and that acquisition resulted in a mitigation agreement, Treasury would likely assign DHS responsibility for monitoring and enforcing the mitigation agreement. Agencies monitoring mitigation agreements provide the committee with a report on all mitigation agreements for which they are responsible at least once per quarter. Monitoring agencies undertake review through site visits, periodic reporting by the firms, and third-party audits.

**Number of Notices**

The number of notices filed with CFIUS generally reflects the health of the economy and can vary from year to year, as seen in Figure 1. The overall trend since 2008 (the first full year of data following the enactment of FINSA) shows CFIUS notices reviewed varied significantly over the past eight years. The sharp drop in notices reviewed after 2008 reflects the financial crisis. The number of notices does not, by itself, however, provide sufficient understanding of the changing investment landscape and CFIUS’s role in it. Post-FINSA, each year has seen an increase in the number of notices that have gone into investigation. In 2014 (the most recent year for which data is available), 51 cases required investigation—approximately one-third of notices filed with CFIUS. While this was a percentage decrease from the prior year, on average, this percentage is in line with the average percentage over the period since 2008.

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Seven years of aggregate data shows that CFIUS has reviewed a total of 782 notices (Table 1). It is also worth noting that of that total, 606 notices, or the vast majority reviewed by CFIUS, involve parties based in a treaty ally or close security partner country.\(^2\) One hundred ten CFIUS-reviewed notices involved either China or Russia, accounting for approximately 7 percent of total cases. In each of the past three years, China was the largest country of origin for CFIUS notices.

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\(^2\) Calculations based on dataset compiled by authors. Treaty allies include NATO members, Japan, South Korea, Australia, Philippines, and Thailand. Close security partners include Austria, Bahrain, Finland, Ireland, Israel, Kuwait, New Zealand, Qatar, Saudi Arabia, Singapore, Sweden, Taiwan, and the United Arab Emirates.
Table 1. CFIUS transactions by year of transaction, 2008–2014

<table>
<thead>
<tr>
<th>Year of Report Publication</th>
<th>Covered Transactions (30-day review)</th>
<th>Withdrawn during Review</th>
<th>Investigation (45-day continuation)</th>
<th>Withdrawn during Investigation</th>
<th>Refiled</th>
<th>Withdrawn, Not Refiled</th>
<th>Presidential Action</th>
<th>Mitigation Measures</th>
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<td><strong>267</strong></td>
<td><strong>52</strong></td>
<td><strong>50</strong></td>
<td><strong>39</strong></td>
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</table>

Source: Data drawn from annual reports to Congress released by the Department of Treasury.

In addition to the trend in recent years of a growing number of CFIUS notices from firms based in China, (full roster of filings by country in Table 2) discussions with CFIUS stakeholders suggest a second trend emerging within CFIUS. Specifically, that a growing number of cases involve ownership structures that are complex or opaque, such as multilayered partnerships.

Cases where the ownership structure of the acquiring party in a transaction is complicated or opaque can stem from the nature (and number) of corporations or other business entities involved, with each participant potentially having a different degree of decisionmaking authority, and hence, control, of the acquiring entity. For example, an entity that is owned by three partners, two Americans and one foreigner, makes an offer to acquire a U.S. company that makes specialized software, including for advanced U.S. fighter jets. In order to determine whether a CFIUS notice should be submitted, a determination would need to be made about the extent to which the foreign partner could control the entity and, therefore, the U.S. business. This question involves an examination of, among other factors, the ownership interest and whether the foreign partner would receive governance rights in respect of the acquired firm. Assessing this information from outside of the partnership can be particularly challenging.

Adding yet another layer of complexity is the possibility that any one partner in a partnership could be, itself, controlled by multiple partnerships. When this happens, it can be time consuming to identify the nationality of the parties involved as well as the ownership and control vested with each member in the overall ownership structure.

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Table 2. CFIUS-reviewed notices, by country, 2008–2014

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<th>Country</th>
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<th>2010</th>
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<th>2013</th>
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These investment structures and practices are increasingly used across business sectors throughout the global economy. There is nothing inherent in such a structure that seeks to avoid regulation or obfuscate. Rather, the ease with which the entity can be formed, and the simpler management structure—from a business perspective—illustrates why partnerships are often used to manage investment undertakings. From a CFIUS review perspective, however, these structures are often more difficult to understand and analyze for the types of risks to national security that CFIUS reviews seek to understand.

Increasing investment in the United States by foreign government-owned or controlled funds, such as sovereign wealth funds, also can raise complicated issues including determining the extent of foreign government ownership or control in the acquired company, and the extent to which such a fund can be expected to operate solely on market principles or if there are elements of national policy objectives included in the investment decisions. Many countries operate investment companies, such as Norway, Saudi Arabia, and Singapore. If a determination is made by CFIUS that a particular transaction is foreign government controlled because the acquirer is controlled by a foreign government, as is generally the case with sovereign wealth funds, there is a presumption that the case will require a 45-day investigation, unless a joint determination is made by the deputy secretaries of the colead agencies that the transaction “will not impair” national security, thereby allowing CFIUS to conclude action within 30 days. Although this is a higher standard than “no unresolved national security concerns,” these determinations are not uncommon.

In addition to the complex ownership structures noted above, those familiar with the process pointed to the 2012 Ralls case as an example of a likely emerging area to monitor: CFIUS filings based on proximity to sensitive areas. In the Ralls case, a company owned by citizens of China acquired four wind farm projects for the purpose of operating wind-turbines for power generation. The land on which these projects were situated was located close to sensitive U.S. military test ranges. Following a notice solicited by CFIUS and subsequent CFIUS review and investigation, President Obama ultimately ordered the divestiture of the land parcels in question because of what he deemed to be credible evidence that the owners of the firms may “take action that threatens to impair the national security of the United States.” Subsequent analysis of the case and the president’s decision highlighted the ways in which the Ralls decision represented continuity with previous determinations of concerns based on proximity to defense installations.

Even as the challenges to determining risk deriving from ownership and control grow, and the growing number of cross-border transactions increases the chance that some investment will trigger CFIUS concern based on situational risks like proximity, it is important to note that CFIUS is intended as a last line of defense. It operates where no other laws are adequate and appropriate to address an identified national security risk. Though an important tool in preserving U.S. national security while preserving a dynamic and open market, working group discussants and others interviewed for this study noted that CFIUS was a tool of last resort.

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Summary of Working Group Discussions

As part of the study effort, the CSIS team assembled a group of current and former government officials who participated in CFIUS as well as individuals with experience on the business and private-sector legal sides of CFIUS transactions to better understand how the process works, where it is working best, and how it might be improved. Over the course of three meetings during 2015, the working group examined a range of issues, including the impact of the review timeline on the government and private sector; questions about the definitions used in CFIUS review; the desired role for interaction between parties to a transaction with those in government; and options for structural changes that would provide more time, additional staff, or alter the document requirement from parties to CFIUS-covered transactions. During these discussions it became increasingly clear that the initial hypothesis—while CFIUS worked, it needed a fair amount of adjusting seven years after the passage of FINSA—was not a view shared within the CFIUS stakeholder community, nor was it reflected in an assessment of the data. Stakeholders frequently offered specific adjustments to the process that would improve the process from their particular viewpoint. But, in nearly all cases, when explored within the working group, the resulting discussion revealed that making even marginal improvements for one stakeholder group would often impose disproportionate negative impact on other stakeholder groups. Over the course of the conversation, the various groups typically came to consensus that, on net, the costs of significant change outweighed the expected benefits.

Selected Discussion Items

**Impact of the review timeline on the government and private sector.** At the outset of the study effort, the CSIS team heard from working group members a concern that the fixed timelines for CFIUS review could sometimes pose a problem for the member agencies responsible for conducting the reviews. Several options were explored within working group discussions. First, adjusting the interpretation of “30 days” to be defined as business days, rather than calendar days. Second, excluding from the calculation days on which the federal government was shut down—such as occurs during a lapse in appropriations.

In both cases, consensus emerged among working group members that the clarity of the timing of the CFIUS process was helpful for parties considering a transaction: clear decision points allow firms undertaking transactions to better manage the potential time-related risk to concluding their transaction. In particular, several participants noted the benefits of maintaining the 30-day review period of CFIUS. This timing, aligned with the 30-day antitrust review process required under the Hart-Scott-Rodino premerger notification provision, aligns the national security review of CFIUS with the antitrust review of the Department of Justice and Federal Trade Commission.

**Questions about the definitions used in and scope of CFIUS review.** Several working group members noted concerns about inconsistent interpretations by senior members of CFIUS agencies relating to the standard established in the law for closing a case—“no unresolved national security concerns.” To be approved by CFIUS, each member of the committee must affirm that the transaction being considered poses “no unresolved national security concerns.” As noted by some working group members, this is a potentially high bar to overcome.
Beyond how to interpret the definitions used in CFIUS, the group considered what scope of cases CFIUS should be applied to. In particular, some participants noted the intent of CFIUS to serve only where other legislation did not already provide for the review or consideration of relevant national security concerns. This was made more clear in subsequent discussions noting the committee report that accompanied FINSA, which states that mitigation measures should not be considered a “first line of defense” to address national security concerns. Instead, CFIUS reviews and any resulting mitigation agreements should focus on threats arising directly from the transaction and should be applied only when no other areas of law or regulation adequately mitigate such risk.6

Additionally, some working group members highlighted a potential for misunderstanding the role of CFIUS, especially when foreign investors may acquire noteworthy—though possibly not national security-relevant—companies. One example was national security concerns raised about the acquisition of the AMC movie theater chain by the Dalian Wanda Group. While noteworthy as a major acquisition in the entertainment industry by a firm from China, some participants noted that there are few national security risks inherent in operating movie theaters. The complexity of the modern economy, however, sometimes leads mundane-seeming transactions to require an extra level of scrutiny—such as when movie theaters are operated on U.S. military bases.

Ultimately the working group discussions resulted in general agreement that appropriate ways to address these issues regarding definition and scope lay in establishing a common understanding of the process for newly confirmed senior leaders at CFIUS member agencies, including ensuring clarity of what was, and was not, part of the CFIUS review.

Dialogue between the government and the parties is important. Working group members consistently highlighted the importance for early and regular dialogue between the parties to a transaction and the government. The complexity of commercial transactions and the potential requirement that government concerns cannot be presented in a fully transparent way were both seen as reasons to engage more—before and after filing. Consultation is valuable for the government as it seeks to quickly and accurately understand the nature of the parties involved in the transaction as well as the potential risks such a transaction may pose to U.S. national security. Further, in cases where mitigation measures must be implemented, for all sides of the process to understand what is expected and what is possible—especially on the often-short timelines—is greatly facilitated by regular dialogue. Treasury has taken steps over recent years to increase the frequency of dialogue across the range of CFIUS stakeholders in ways welcomed by many working group participants.

Annual public reporting lags the business cycle. Working group discussions highlighted that the annual reporting process, especially as it has come to be released approximately 12–14 months after the end of the reporting period, does not provide timely insight into the kinds of national security concerns that are being looked at by the committee. This view was not shared by working group participants—and others interviewed—who are directly involved with the CFIUS process and its oversight from the legislative branch. Private-sector stakeholders assess that investment trends emerge and recede within the current reporting cycle.

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**U.S. markets remain open for investment.** Discussions in the working group sessions noted that the increase in transactions undergoing CFIUS review reflects a broader trend in global financial flows: the United States has been one of the leading destinations for foreign direct investment globally for the past several years. In 2013, the United States was the destination of over $127 billion. 2014 saw a similarly high level of investment in the United States, at $112 billion. The first three quarters of 2015 saw FDI into the United States exceed $320 billion. CFIUS reviews continue to impact a very small number of total foreign investment transactions into the United States, and there was consensus among participants that CFIUS did not undermine the openness of U.S. markets. Several working group participants went further, asserting that the level of transparency and clarity of the CFIUS timeline CFIUS provides a more navigable process than many other countries national security review processes for foreign investment.

**Growth in the number of investigations.** Even as the number of notices reviewed generally reflects the broader investment trends for the United States, the number of cases entering investigation has been on an upward trend. Cases enter into investigation when there is a need for further due diligence by member agencies, the transaction is foreign government controlled, or the transaction involves “critical infrastructure.” Discussion with working group participants suggests a growing role for private equity and for sovereign wealth funds in acquiring U.S. businesses in recent years. These cases can often present complicated ownership structures that may require additional time for the committee to assess.

**Appropriate resourcing for monitoring mitigation agreements.** Discussants noted, and the data reflect, that an increase in the number of cases reviewed is driving a growing number of mitigation agreements to be monitored. This phenomenon of steady growth in cases could make long-term monitoring difficult without additional resources. Current officials noted that at present this was not an issue.

**Growth in nontraditional investors.** As noted above, the relative number of CFIUS filings originating in nontraditional partners of the United States, and specifically China, has grown in recent years. Working group discussions noted this trend and identified it as an area for continued monitoring within the CFIUS process.

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Findings

This report has three major findings. First, the CFIUS process is working. Next, while the CFIUS process is working, there are increasing risks to the system related to the volume and complexity of transactions, and the ability of monitoring agencies to conduct sufficient follow-up on mitigation agreements. These risks do not undermine the utility or viability of the process, but merit close monitoring. Eight years after the enactment of FINSA, the process provides adequate oversight on clear and largely predictable timelines. Finally, increasing communication through interactions and clarifying guidance could improve the process.

CFIUS Is Working

The CFIUS process is working. Based on clear timelines and structure, CFIUS provides the business community with a reasonably predictable process while allowing for a rigorous review by CFIUS member agencies. The voluntary nature of CFIUS contributes to its success—as firms file to ensure they do not encounter disruptive regulatory intervention later—while enabling the vast majority of cases without security implications to forego CFIUS entirely.

Desire for Regular Communication between Stakeholders

The CFIUS process involves stakeholders from across the federal government and the private sector. The range of potentially involved parties can create an uneven understanding of the role of the process, and create challenges for effective communication both within, and about, the way CFIUS works. This study identified two findings related to communication. First, there was great interest from working group participants from the private sector to ensure a sustained dialogue with the government before and during the review process. Parties noted greater openness to regular dialogue recently and encouraged that trend to continue. Second, CFIUS filings involved at least 22 industry sub-sectors in 2014, according to the annual report covering transactions reviewed that year. The range of firms potentially needing to consider a CFIUS filing suggests the importance of regular outreach by CFIUS to inform and educate sectors on the purpose and requirements of the CFIUS process.

CFIUS Regulations Understood Unevenly

Despite the seeming clarity of the CFIUS regulations, working group discussions highlighted that even for those with significant experience with CFIUS, there were areas of the regulations that resulted in differing interpretations as to what was required to be filed, and whether a transaction would be covered. For instance, example 9 in the section of the regulation describing control
provides a list for what constitutes control by a limited partner. Some practitioners assessed this list could be viewed as exhaustive; however, interviews with experienced practitioners suggest the list is not exhaustive. Examining the current regulations for other such ambiguities could help clarify requirements for new entrants to CFIUS.

Risks in the Process Are Potentially Increasing

The clarity, rigor, and transparency enacted within CFIUS as part of FINSA has created a strong system that remains focused solely on national security issues. However, emerging trends bear close monitoring as they could—over time—reduce the effectiveness of the system. Specifically, these include the increasing complexity of transactions, the growing role of foreign government-owned or controlled entities in mergers and acquisitions, the growing number of cases filed with CFIUS, the capacity of agencies responsible for mitigation monitoring to effectively conduct oversight as the number of mitigation agreements grows. These risks do not undermine the effectiveness of the CFIUS process, but bear watching over time.

Complex ownership structures of the acquiring firms filing with CFIUS add layers of difficulty and therefore perception of risk. Within the United States and globally, a trend toward increasingly complex ownership structures of acquisition vehicles is emerging. Embodied by, but not limited to, private equity firms, the resulting corporate structures can be complex and require high levels of due diligence to fully understand. Combined with the ease with which capital can cross borders, and the openness of the U.S. market, performing sufficient analysis of the parties to a transaction requires specialized expertise, is increasingly time consuming, and may increase perception of risk by government officials when making national security evaluations.

For example, a private equity firm may bring together five of its investors to form a limited liability partnership or corporation for the purpose of acquiring a U.S. company with contracts relating to national security. The nature of the newly established firm, often utilized because it facilitates the rapid creation of the necessary corporate entity, can sometimes limit the availability of information about the partners involved. As a result, the time and effort to investigate the nationality of the investors and their connections—if any—to foreign governments can be highly complex.

Similarly, as state-controlled entities, including sovereign wealth funds or state-owned or controlled enterprises, increasingly look beyond their borders to acquire firms for commercial or national benefit (or both), identifying whether these transactions pose risk to U.S. national security becomes increasingly challenging.

As case complexity grows, and even though the number of transactions filed each year fluctuates with broader market trends, the number of mitigation agreements is accumulating at a steady pace, with more than 40 new mitigation agreements concluded since 2010.

Officials inside the CFIUS process note that overall, most cases are not as complicated as the example above, and that they are able to manage mitigation agreements based on the current staffing and workload. However, increasing utilization of private equity and other potentially less-transparent corporate structures, and the ongoing accumulation of mitigation agreements, merits continued monitoring.
Recommendations

The CFIUS process continues to work well. There are several instances, though, where specific adjustments may result in an overall process that better serves the participants and the objectives of the committee. We present these below.

**Sustain dialogue between government and parties.** Working group participants noted the challenges to transacting parties, and to government officials making assessments, when dialogue across the government-private sector divide was difficult. Working group participants have seen improvements in this dialogue over the past year—in particular the ability of colead agencies to interface with the parties to the transaction in ways that were not often possible over the past several years. This is an important avenue to best facilitate clear understanding throughout the process.

Benefits of this greater exchange are that it provides officials with an enhanced ability to quickly address questions or uncertainties that may take much longer to sort out through independent research. It also provides transacting parties an opportunity to better understand the nature of the concern from the government—and adjust their investment strategy accordingly.

Enhanced communication between the colead agency and the transacting parties does increase the risk that the government will be in a position of providing different responses to questions from parties. However, the current process, which seeks to ensure that colead agencies are party to all communications and invited to all meetings, mitigates that risk sufficiently.

**Hold a regular “Industry Day.”** Throughout the working group process, participants regularly commented on the value of having regular—though not necessarily frequent—opportunity to hear from and talk with other stakeholders in the CFIUS process. Opportunities such as an “industry day” hosted under the government’s auspices, or through a neutral outside organization, would establish a venue for parties with an interest in CFIUS to learn more about the process, and for the government to better explain its approach and rationale to interested parties.

Industry Day functions are utilized by several federal departments, including State, Energy, Homeland Security, and Defense, to familiarize government and nongovernment actors on way the government will approach a specific process or issue set. In addition to being a forum to convey government intention, it is also an opportunity to take feedback and solicit inputs in an open forum which could be considered for process improvements in the future. One model that CFIUS could draw upon is the annual conferences hosted by the Defense Security Service (DSS) for Foreign Ownership Control or Influence (FOCI) proxy holders and facility security officers. DSS
uses its annual conferences to highlight emerging issues, disseminate changes in its procedures, and to engage with stakeholders.

**Periodically update CFIUS guidance.** Treasury issued Guidance in 2008 after the passage of FINSA, "Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States." This guidance discussed the kinds of cases that CFIUS had reviewed at that point that had raised national security considerations. But as the types of cases that CFIUS now reviews and concepts of “national security” have evolved, so too must this guidance. Treasury should consider updating its guidance so that the public can benefit from a greater understanding of the types of cases that CFIUS now reviews—in 2016 and into the future. Consideration should also be given to reissuing guidance on a regular basis. Working group participants and government officials interviewed provided wide-ranging views on this question, with many asserting the regulations are sufficient. Additionally, emerging trends in transactions—notably toward greater corporate complexity and less clear ownership and control relationships within acquiring or investing partnerships—suggest it is worth considering updating the CFIUS guidance. Specifically, updating the guidance to clarify the types of information deemed most helpful (even if not required by regulation or statute) to facilitate the review of filings where the ownership structure of the acquiring party is particularly complex.

**Enhance risk-management practices and monitoring of emerging concerns.** While the CFIUS process generally is doing an excellent job of focusing its limited resources on transactions of the most concern, CFIUS-member agencies should examine whether they could further refine this approach by equitably adjusting risk-adjudication criteria for parties with long-standing records of compliance with CFIUS mitigation requirements. This could enable a more streamlined process for cases where the parties have a strong track record of compliance and are deemed to be of lowest risk. Even as CFIUS seeks to manage risk of known entities, it must also ensure that it maintains visibility on emerging risks. Several working group participants noted the apparent growth in transactions where at least one party was privately held—especially those where the corporate structure was a partnership. As discussed above, some of these entities have complicated or opaque ownership structures. The complexity of these ownership structures places an even greater evaluative burden on reviewing officials within the CFIUS process to make determinations based on limited information.

Working group members outside of government suggested that complex partnership structures were often the result of private equity funds who essentially operate with a roster of possible investors. The private equity funds seek to align investor interests with desired returns in a way that expedites deals being closed successfully. For firms engaged in this type of transaction, particularly if they do not regularly engage in CFIUS-related work, it may not be clear to them which investors trigger a CFIUS review. As noted above, over 80 percent of cases filed with CFIUS in the past 10 years have involved individuals from close security partners of the United States.

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There is no indication that any specific corporate structure has been used to circumvent CFIUS. However, the growing complexity of some cases indicates this as an area that executive branch and congressional leaders should continue to watch to ensure CFIUS officials have the tools needed to properly evaluate increasingly complex transactions in the timelines required under FINSA.
Conclusion

As the United States seeks to protect national security while encouraging investment, the CFIUS process works well as a review and evaluation mechanism. A trend throughout the economy over the past decade has been that investments and mergers and acquisitions are increasingly complex in terms of ownership structure and from a greater array of countries. In the global market, the United States is often seen as a safe destination for investments.

It is within this overall economic context that CFIUS conducts its work. The CFIUS process largely works well and largely achieves the goal of encouraging investment while protecting national security, as appropriate. While stakeholders from within CFIUS and those who participate in it from the private sector note there are small changes that could improve the process, including enhancing communication with those outside government and periodically updating the CFIUS guidance, the clear sense is that the overall structure and implementation remain effective. Current trends in transaction complexity and the increasing role of state-backed commercial entities undertaking investments in the United States are areas to watch, but at this time are not sufficient to merit legislative adjustments to CFIUS. Stakeholders across the CFIUS community in the government and private sector are generally supportive of the functioning of CFIUS post-FINSA.
CSIS Review of CFIUS

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From 2005 to 2011, Mr. Hunter served as a professional staff member of the House Armed Services Committee, leading the committee’s policy staff and managing a portfolio focused on acquisition policy, the defense industrial base, technology transfers, and export controls. From 1994 to 2005, he served in a variety of staff positions in the House of Representatives, including as appropriations associate for Representative Norman D. Dicks, as military legislative assistant and legislative director for Representative John M. Spratt Jr., and as a staff member for the Select Committee on U.S. National Security and Military/Commercial Concerns with the People’s Republic of China. Mr. Hunter holds an M.A. degree in applied economics from the Johns Hopkins University and a B.A. degree in social studies from Harvard University.

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CSIS Review of the Committee on Foreign Investment in the United States

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