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Are US outbound investment restrictions coming?

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The US government has enjoyed authority to review certain foreign investment transactions in the US for decades.

Behind such authority stands the belief that some types of foreign direct investments (FDI), particularly by entities owned or controlled by foreign governments, may adversely affect US national security interests. President Gerald Ford established the Committee on Foreign Investment in the United States (CFIUS) in 1975 to address concerns that certain types of FDI in the US by members of the Organization of the Petroleum Exporting Countries were driven by political motives.

CFIUS operated in relative obscurity until 2006, when Dubai Ports World (DP World) was given the green light to purchase the commercial port operations of the British-owned Peninsular and Oriental Steam Navigation Company (P&O), which included six US ports. The proposed transaction was subjected to widespread criticism and triggered demands for greater congressional oversight of CFIUS deliberations. The rise of state-owned enterprises as investors in US assets accelerated the shift towards assessing whether specific transactions pose a risk to national security.

The number of investments blocked by CFIUS since inception has been limited, although many more transactions may have been discouraged by the threat of a potential block. In one recent example, President Trump blocked the acquisition of Qualcomm by Broadcom in 2018. More recently, President Biden issued an Executive Order to CFIUS on 15 September. The Order instructed the Committee to broaden the scope of its reviews through the implementation of a more restrictive technology transfer and capital flow regime.

Rules governing outbound investments would be a novel step

While a mechanism to review foreign investment into the US is well-established, there are few limitations on outbound investments. There has been growing debate in Washington DC in recent years around the creation of such system. As recently as 2021, the United States Innovation and Competition Act (USICA) would have established a committee, usually referred to as "CFIUS in reverse", with authority to review US investment in countries deemed "foreign adversaries" that pose an "unacceptable risk" to US national security. The initiative didn't gather enough support then due to opposition from various private sector groups, who argued that the mechanism was too broad and would create numerous compliance issues for businesses and government.

Debate around these ideas has picked up steam this year, and a new executive order appears on the horizon. According to various media reports, advanced semiconductors, some types of artificial intelligence, biotechnology, decryption capabilities, and critical materials could be in scope. There is still considerable uncertainty regarding the extent of new restrictions, but recent reports suggest existing investments that occur before the issuance of an executive order would not be affected. Nor would capital already invested in foreign companies through publicly traded assets.

Investment implications

We expect tensions in the US-China bilateral relationship to remain elevated. A regime of increasing restrictions on technology transfer and capital flows between the two nations is likely to take hold and become a persistent irritant.

Any assessment of the concrete impact from the adoption of outbound investment restrictions by the US is subject to considerable uncertainty at this point. The final details of the rules matter greatly, including what type of investments and industries may be within scope and the speed of implementation, among other aspects.

The debate around outbound restrictions has already triggered some anxiety among US investors and is expected to reduce cross-border private equity investment. The opportunity set for many managers is being reduced. Funds have been aware of the regulatory trends and have exercised caution in investing in cross-border in critical industries and technologies with national security applications for some time. Due diligence costs are expected to increase for those funds focused on sensitive areas.

In addition, we expect US companies to continue their diversification of capital investment through "near shoring" and toward nations whose national security interests are more aligned with the US and less susceptible to supply chain interruption. We expect greater clarity on the approach adopted by the Biden Administration as the year progresses.

For more information, please review the following pieces on the topic we have recently put out:

- **Stress-testing our views on the future of US-China engagement: A conversation with Robert Daly**
- **Pivotal November? The future of US-China engagement**
- **US-China ADR saga: Sword of Damocles removed for now**
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