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**Research Report**

## CFIUS and the cost of risk aversion

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Perspectives on topical foreign direct investment issues

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### **CFIUS and the cost of risk aversion**

by

Stephen Heifetz\*

Suppose your doctor said, “I’ll prescribe medicine only if I’m convinced it creates no risks.” You would change doctors, because every medicine has *some* risk of unwanted side effects, but often the benefit outweighs the risk. This is true of many facets of life. The decision to drive a car creates risk, but it is generally impractical—and inadvisable—to live with a “no risk” standard.

This “no risk” standard, though, governs the Committee on Foreign Investment in the United States (CFIUS). Congress directed that CFIUS may not approve a foreign investment into a US business, unless CFIUS can certify that there are “[no unresolved national security concerns](#)”. CFIUS is comprised of senior government officials who must provide that certification.

The “no unresolved concerns” standard creates situations like the following. There is a European investor seeking a 20% stake in a US start-up company. The start-up makes artificial intelligence software with potential military uses. Like many start-ups, it has no income and needs the investor’s money to pay its employees. Without a quick injection of capital from the European investor, the start-up might die—no other potential investors are offering sufficiently favorable terms. The future benefits the start-up might provide, including to the US military, depend on the European investment.

The investor, though, has invested globally, including in China. That concerns CFIUS: maybe there is Chinese influence on the European investor, and maybe that influence could be exerted on the US start-up. The chances of that happening seem low, but not zero.

A CFIUS official might conclude the investment is in the national security interest despite these modest concerns. The certification language, however, is that there are *no unresolved concerns*. A potential resolution—say, mandating the start-up to pay for an external monitor to ensure no

Chinese influence—might not be financially feasible. Too bad for the US military that might have benefitted from the start-up.

The “no unresolved concerns” standard is one-sided, like the “no-risk” doctor who does not weigh competing considerations. Unfortunately, this one-sidedness is increasingly emblematic of CFIUS.

The CFIUS mandatory filing rules provide further illustration. Prior to 2018 amendments, CFIUS had wide authority to find foreign deals of potential concern and force divestment. Transaction parties could (and often did) make *voluntary* filings to obtain a “safe harbor” against forced divestment—CFIUS approval ensured no future adverse action by CFIUS. But there were no mandatory filing rules.

With the 2018 advent of rules that require filings for a slice of transactions, the number of CFIUS filings predictably has increased. More significantly, the number of transactions that lawyers must review—to determine whether a filing should be made—has exploded. That figure now is likely in the tens of thousands annually. This has increased capital costs for US companies, and some investments are deterred or reduced in size. The transactions for which the filings are required do not correspond closely to national security risk; as argued [elsewhere](#), the current mandatory filing rules cannot be justified on any reasonable cost/benefit basis.

These downsides of tighter investment screening, though, have not been a meaningful part of the CFIUS calculus. Particularly since 2018, it has been a one-way ratchet to reduce risk, regardless of competing considerations.

These competing considerations are monumental. What is the source of US strength? It is magnetism—the ability to draw inward global resources such as capital, talent and entrepreneurial companies. Countries achieve and maintain great power status by becoming magnets. The Persian, Roman, Tang, Mongol, Dutch, British, and US great powers are illustrative of the critical ingredient of magnetism.

At the 2008 Beijing Olympics, journalist Thomas Friedman noted “[The Russian team all looks Russian; the African teams all look African; the Chinese team all looks Chinese; and the American team looks like all of them.](#)” That remains true of the competition to be the global business center today: companies around the world frequently develop a US presence, and global investors want to invest in US companies.

But this US magnetism is not immutable. By several measures it is diminishing: the share of venture capital dollars flowing to US start-ups, for example, has [dropped from over 80% to approximately 50% in the past two decades](#). It is impossible to say how much of this decline is attributable to CFIUS. But it is easy to conclude CFIUS gives little weight to the benefits of attracting global resources.

What can be done? There are many contributors to CFIUS risk aversion. Some are politically intractable. But amending the “no unresolved concerns” standard should not be difficult if the alternative is phrased to avoid implying a subordination of national security. Giving CFIUS authority to approve an investment when that investment is “in the national security interest”

would avoid that implication. At the same time, this would eschew a “no risk” standard, allowing for competing considerations, such as difficulties faced by US start-ups as capital becomes more costly. Perhaps the national security interest favors a freer flow of inward capital even if remote concerns are attached. Inability to extinguish concerns should not automatically cause the CFIUS Doctor to say “no”.

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