

**Making Exceptions to Foreign Direct Investment Regulation:
How an Opaque Federal Regime May Be Magnifying Abnormal Returns**

by

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ABSTRACT

With the intention of protecting its national security interests, the United States federal government established the Committee on Foreign Investment in the U.S. (CFIUS). This regime has grown to harness vast authority to block certain foreign direct investments (FDI) which it deems to be threatening to national security. Prior literature has indicated that CFIUS can potentially create deadweight loss in the economy, have negative impacts on the merger-arbitrage spreads for U.S.-domiciled companies, and deter FDI with its lengthy and costly review process. Some also criticize the fact that the expansion of CFIUS's powers has been accompanied by little oversight or transparency for the American public. What has yet to be explored with empirical analysis in existing literature, however, are the effects of CFIUS making exceptions to its mandatory filing requirements for its Five Eyes friends – the United Kingdom, Canada, Australia, and New Zealand. With an Excepted Foreign State status, investors and acquirers domiciled in one of these states are afforded advantages in the American mergers-and-acquisitions (M&A) marketplace, the value of which has yet to be quantified until now. This paper utilizes M&A data (with 238 transactions after filtering), obtained through the SDC Platinum database. Through a difference-in-difference analysis, this paper finds that U.S. companies involved in M&A transactions with an investor domiciled in a CFIUS-excepted state experience an estimated 4.59% higher cumulative abnormal stock return post-announcement. However, there is enough uncertainty in this estimate that we cannot reject the null hypothesis of no effect at standard levels of statistical significance. In any case, it is possible that the CFIUS review process makes investors doubtful of a merger or acquisition being completed.

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I. INTRODUCTION

How much autonomy should private actors have within a capitalist system? When is regulation of a free-market economy necessary? What are the consequences when that regulation is imposed? While such questions have proliferated widely into certain academic discussions, one area in which it has failed to sufficiently reach is foreign direct investment (FDI) regulation. While it is the goal of most globalized economies to maximize FDI inflows, the question of national security mandates government intervention.

In the U.S., the Committee on Foreign Investment in the United States (CFIUS) is the regulatory body tasked with overseeing international transactions involving American entities and is empowered to block certain transactions which it deems to be a threat to national security. Some transactions, however, are offered a more preferential treatment and receive certain exemptions. These transactions are those which involve foreign actors domiciled in a Five Eyes state (the U.K., Canada, Australia, and New Zealand), also known as Excepted Foreign States.

While prior literature has sought to understand some of the economic and financial impacts of CFIUS interventions in FDI inflows to U.S. companies, the treatment effect of the Excepted Foreign State designation on stock market returns for American companies has yet to be explored or quantified. For the purposes of this paper, only the first three of the aforementioned Excepted Foreign States are considered in the treatment group. That is, this paper assesses the treatment effect for just the United Kingdom, Canada, and Australia, the rationale for which will be expanded upon later in the paper.

This study calculates cumulative abnormal returns using event studies for each M&A transaction in a dataset extracted from the SDC Platinum database. I conduct a difference-

in-difference analysis and regression to explore the difference in average abnormal returns experienced by U.S. companies post-announcement of a merger or acquisition. It compares when an Excepted Foreign State is involved (pre- vs. post-CFIUS designation) versus when any other country (pre- vs. post-CFIUS designation) is involved. I find that transactions which involve a foreign investment from an Excepted Foreign State experience a 4.59% higher abnormal return post-announcement than their counterparts, with the recognition that there is enough uncertainty in this estimate that we cannot reject the null hypothesis of no effect at standard levels of statistical significance. This finding is a crucial and necessary addition to the current academic understanding of CFIUS. It is informative to private stakeholders as well who may wish to better predict market reactions to an M&A announcement. This finding suggests that an Excepted Foreign State designation from CFIUS may result in a non-trivially high return for the relevant American publicly traded company. In other words, transactions with non-Excepted Foreign States may experience a 4.59% *lower* return post-announcement than the treatment group may. This leads to questions about how CFIUS makes exception determinations and whether additional countries should be routinely added to this list. If such an opaque federal regime can have substantial impacts on returns realized by American companies and their investors, there is a compelling reason to call for additional oversight of CFIUS and transparency for the American public. This section of the paper will first provide a brief history and background on CFIUS and will then move into a deeper exploration of the Excepted Foreign State designations.

A. *What is CFIUS?*

The Committee on Foreign Investment in the United States was initially formed through an Executive Order by President Gerald Ford in 1975. It stipulated that a committee shall be formed in order to “review investments in the United States which . . . might have major implications for United States national interests.”¹ This committee was to be an inter-agency effort comprising the Departments of State, Treasury, Defense, Commerce, along with the U.S. Trade Representative, the Chairman of the Council of Economic Advisors, the Attorney General, and the Director of the Office of Management and Budget.²

Given that CFIUS at this point had minimal true enforcement power³, the Exon-Florio Amendment of 1988 was passed which granted the President of the United States powers to investigate “foreign acquisitions, mergers, and takeovers of, or investments in, US companies” and block certain transactions on national security grounds.⁴ The next change that CFIUS underwent came with the Byrd Amendment in 1992 which required a CFIUS investigation over a “covered transaction” which is “any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States,” placing special consideration on “critical infrastructure.”⁵

In 2007, Congress passed the Foreign Investment & National Security Act (FINSA) which expanded the Committee, offering membership to the Secretary of Energy and

¹ *Exec. Order No. 11,858, 3 C.F.R. (1971–1975)*

² *Id.*

³ Souvik Saha, *CFIUS Now Made in China: Dueling National Security Review Frameworks as a Countermeasure to Economic Espionage in the Age of Globalization*, 33 *Nw. J. Int'l L. & Bus.* 199 (2012).

⁴ *U.S. National Security and FDI*, 33 *Institute for International Economics*

⁵ 50 *U.S.C. app. § 2170(d)* (2006).

ex-officio membership to the Director of National Intelligence and the Labor Secretary.⁶ Most recently, Congress passed the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) which broadened the scope of CFIUS's investigations and allowed for longer investigation timelines.⁷ Specifically, FIRRMA added four new types of transactions which would now fall under a "covered transaction":

"(1) a purchase, lease, or concession by or to a foreign person of real estate located in proximity to sensitive government facilities; (2) "other investments" in certain U.S. businesses that afford a foreign person access to material non-public technical information in the possession of the U.S. business, membership on the board of directors, or other decision-making rights, other than through voting of shares; (3) any change in a foreign investor's rights resulting in foreign control of a U.S. business or an "other investment" in certain U.S. businesses; and (4) any other transaction, transfer, agreement, or arrangement designed to circumvent CFIUS jurisdiction."⁸

Critical to this paper, FIRRMA also made certain transactions subject to mandatory filing requirements.⁹ Excepted Foreign States, however, are offered certain exemptions from these mandatory filing requirements. As a result, this paper focuses on M&A transactions post-FIRRMA in order to best isolate the benefits attributed to Excepted Foreign States and, consequently, the effects of Excepted Foreign State designations on market returns

⁶ *CFIUS Reform: The Foreign Investment & National Security Act of 2007 (FINSAs)*, The Department of the Treasury, Nov. 14, 2008.

⁷ *FIRRMA FAQs*, The Department of the Treasury

⁸ *Summary of the Foreign Investment Risk Review Modernization Act of 2018*, The Department of the Treasury

⁹ *Id.*

for the focal firm. When a transaction does not meet the requirements for mandatory filing with CFIUS, a U.S. company may file voluntarily if it wishes to.

This paper refers to CFIUS as an “opaque federal regime,” reflecting the fact that most of the committee’s decision making processes are not made public. While this is understandable in the context of national security concerns, it is still subject to the criticism of many academics. Perhaps best summarized by E. Maddy Berg in the *Columbia Law Review*, “CFIUS has transformed from a relatively powerless monitoring body to a major regulatory hurdle for cross-border deals. This shift has been accompanied by increasing concerns from scholars and transacting parties regarding CFIUS’s lack of accountability and transparency.”¹⁰ Building on those concerns, Eichensehr and Hwang in “National Security Creep in Corporate Transactions” establish the idea that justifying CFIUS action through “national security” has led to the committee having largely unchecked power.¹¹ These arguments are corroborated by Amy Josselyn in the *George Mason Law Review* who suggests that the problem with CFIUS lies in the fact that the Committee uses an overly broad definition of national security to initiate reviews. Josselyn proposes that to remedy such concerns, Congress should provide a narrower definition of what falls under the scope of “national security concerns”, the President should provide feedback to investors, and courts should explore the possibility of some form of judicial review over CFIUS decisions.¹²

¹⁰ Maddy E. Berg, *A Tale of Two Statutes: Using IEEPA’s Accountability Safeguards to Inspire CFIUS Reform*, 6 *Columbia Law Review* 118, 1763-1800 (2018)

¹¹ K.E. Eichensehr & Cathy Hwang, *National Security Creep in Corporate Transactions*, *Columbia Law Review* 123, 549-614 (2022)

¹² A.S. Josselyn, *National Security at All Costs: Why the CFIUS review Process May Have Overreached Its Purpose*, 5 *George Mason Law Review* 21, 1347-1380 (2014)

B. CFIUS Excepted Foreign States

Some foreign entities are exempt from certain mandatory filing requirements if they are domiciled in a state party to the Five Eyes intelligence alliance (Australia, United Kingdom, Canada, and New Zealand). These states are referred to as “Excepted Foreign States” by CFIUS. CFIUS claims to have designated these states as Excepted Foreign States because they “have established and are effectively utilizing a robust process to analyze foreign investments for national security risks.”¹³ With this designation, the Five Eyes states enjoy “exception(s) from CFIUS jurisdiction over certain noncontrolling transactions, real estate transactions, and mandatory filing requirements as established under law.”¹⁴

This is a form of a preferential status that is granted to investors from these countries. As with any discussion of preferential treatment in the context of international law, a discussion of the most favored nation (MFN) principle should be, at least briefly, touched upon.

“Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members.”¹⁵

¹³ *Determination Regarding Excepted Foreign States* 87 FR 731 (January 5, 2022)

¹⁴ *Treasury Takes Action Related to Excepted Foreign State and Excepted Real Estate Foreign States*, U.S. Department of the Treasury (February 10, 2023)

¹⁵ *Principles of the Trading System*, World Trade Organization, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox

Does this imply that CFIUS's Excepted Foreign State list could be a violation of international agreements? Perhaps, although the reason why it has been allowed is likely due to national security exemptions to the MFN clause.

In any case, focusing this paper on the impacts of Excepted Foreign State designations is valuable for quantifying how this preferential treatment impacts not only those transactions involving the Excepted Foreign States but also how other transactions are potentially being disadvantaged by it. Prior explorations into this question reveal that the CFIUS review process can negatively impact the stock prices of the focal firm, disincentivize foreign investment due to its costly and time-consuming nature, and ultimately create deadweight loss in the economy.¹⁶ As a result, in theory, it should follow that M&A deals involving CFIUS Excepted Foreign States will see more positive market reactions than those involving non-exempted countries; investors should view deals with CFIUS Excepted Foreign States more optimistically since they don't have to go through mandatory filings with CFIUS and consequently face fewer costs and barriers to the completion of a deal. Since prior literature in the field has yet to explore the impact of an Excepted Foreign State designation, that is precisely what this study will test. The ultimate goal of this exploration is to be able to quantify the value of the preferential treatment granted by CFIUS to the Excepted Foreign States.

It is critical to specify that while the U.K, Australia, and Canada were all provided Excepted Foreign State status on February 13, 2020, New Zealand was separately granted these privileges almost two years later on January 5, 2022.¹⁷ Since difference-in-difference

¹⁶ Paul Connell & Tian Huang, *An Empirical Analysis of CFIUS: Examining Foreign Investment Regulation in the United States*, 39 *YALE J. INT'L L.* 131 (2014)

¹⁷ *CFIUS Excepted Foreign States*, U.S. Department of the Treasury, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-excepted-foreign-states>

analyses rely on assessing the abnormal stock returns before and after a singular date, this study chose to focus on the February 13, 2020 date. While this meant we could not assess the treatment for New Zealand, this allowed for the maximized use of the data. As a result, “treatment group” in this paper will only refer to the United Kingdom, Australia, and Canada.

The implications of this research are far-reaching. Not only does it open the door for further research and public discourse about a largely unchecked federal regime, but it also quantifies the impact that the CFIUS Excepted Foreign State designation has on the stock prices of U.S. targets. In other words, it provides traders, investors, and other relevant stakeholders with the first empirically backed evidence of the additional alpha that can be generated by conducting business with an excepted entity. Similarly, it begins to uncover the disadvantage non-excepted entities face in comparison.

The paper will elaborate on the methodology used and will present detailed findings, concluding with a brief yet novel approach at utilizing a cosine similarity matrix to spur discussions around comparative analyses between the legislation of different FDI regimes. If CFIUS granted exceptions to the treatment countries based on their use of a “robust process to analyze foreign investments for national security risks,”¹⁸ are there any noticeable similarities or differences between the texts of each country’s FDI screening process and with comparable American legislation (FINSAs and FIRRMAs)? That is, can we potentially predict whether a state will be added to the Excepted Foreign State list on the basis of its FDI regime’s similarity to the U.S. FDI regime?

¹⁸ *Determination Regarding Excepted Foreign States* 87 FR 731 (January 5, 2022)

II. METHODOLOGY

The principal challenge faced in this study was the sparse availability of relevant and tidy data. As a result, this study created a dataset by combining M&A data from the SDC Platinum database with cumulative abnormal returns (CARs) generated for each deal using event studies around each announcement date. Finally, treatment, control, pre-treatment period, and post-treatment period indicators were added to the dataset. For the purposes of this paper, these are defined as follows:

- **Treatment group:** United Kingdom, Australia, Canada
- **Control group:** All other countries in the dataset (excluding New Zealand and those in the treatment group)
- **Pre-Treatment Period (t0):** Transactions before CFIUS designated the countries in the Treatment group as Excepted Foreign States, post-FIRREA (August 13, 2018 - February 13, 2020)
- **Post-Treatment Period (t1):** Transactions after CFIUS designated the countries in the Treatment group as Excepted Foreign States until latest available date (February 14, 2020 - December 31, 2023)

The choice to have the control group consist of simply non-treated countries was largely driven by a desire to maximize the use of available data. In other words, filtering to a smaller control group of only one or a few specific states to compare the treatment group to decreases the number of observations that are being used in calculating average CARs. Due to the following filters, the number of observations (especially in the post-treatment period) were already scarce.

The M&A data was filtered such that only deals that were sought post-FIRREA were included and only publicly traded companies which had a PERMNO identifier when matched with the CRSP database were included. A PERMNO identifier was required for the event study portion of this analysis.

This study employs event studies, a difference-in-difference analysis, and text analysis to try and better understand CFIUS, namely the Excepted Foreign State designations. The event studies were part of building the dataset which was used to conduct the difference-in-difference calculation.

A. Event Study

An event study was done on each observation (each M&A transaction in the data) to identify the cumulative abnormal returns generated post-announcement. Once each observation had a CAR value, these CARs were used in a difference-in-difference calculation. In order to handle running an event study for each observation of the M&A data, the “Event Study by WRDS” platform was utilized, provided by the Wharton Research Data Services. A consideration of the parameters used are as follows.

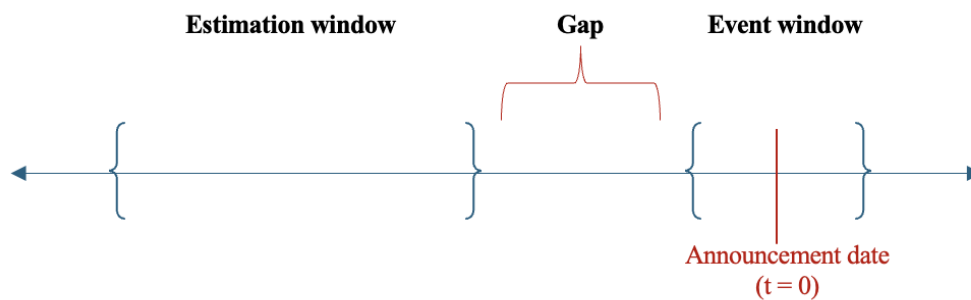


Figure 1: Event Study Timeline

The estimation window is used to estimate expected returns for a given security, and in this case was set to 250 trading days. The gap window is used to reduce the likelihood that the estimation period is affected by the event. In this event study, the gap was set to 50 trading days. The event window is the timeframe surrounding the announcement date and is used to compare against the returns from the estimation window. This comparison between the event window and the estimation window is what yields a value for abnormal returns. Here, the event window was set to -25 trading days to +10 trading days before and after the announcement date, respectively. A consideration of the size of this window is found below.

1. Selecting the Appropriate Event Window

Different papers have used different event windows when assessing stock market reactions to mergers and acquisitions. For example, Rani et al. use a 41-day event window (20 days on each side of the announcement date) to assess the impact of M&A transactions on shareholder wealth in the short-run.¹⁹ By contrast, Duso et al. report that a longer window before the announcement date, specifically 25-50 days prior, heightens the ability of the study to “capture the ex-post merger effect.”²⁰ Considering these findings along with the promising results yielded by Timo Klein’s merger analysis event study,²¹ I chose to use a 36-day event window: 25 days prior to the announcement and 10 days post-announcement. The longer time horizon pre-announcement captures any potential leakages of information

¹⁹ N. Rani, S.S. Yadav & P.K. Jain, *Impact of Mergers and Acquisitions on Shareholders’ Wealth in the Short Run: An Event Study Approach*, *Vikalpa*, 40(3), 293 (2015)

²⁰ Tomaso G. Duso & Burcin Y. Klaus, *Is the Event Study Methodology Useful for Merger Analysis? A Comparison of Stock Market and Accounting Data*, *International Review of Law and Economics* 30, 186 (2010)

²¹ Timo Klein, *Event Studies in Merger Analysis: Review and an Application Using U.S. TNIC Data*, *SSRN Electronic Journal* (2020)

and the shorter time horizon post-announcement reflects the idea that M&A information will likely be absorbed by the market relatively quickly due to factors like news coverage.

B. Difference-in-Difference

Once the CARs were calculated for each observation (each M&A deal) in the dataset and those values were joined to the M&A data in a separate column, a difference-in-difference was then calculated, the general form and parameters of which are described here.

$$(\widehat{Y}_{t=1,x=1} - \widehat{Y}_{t=0,x=1}) - (\widehat{Y}_{t=1,x=0} - \widehat{Y}_{t=0,x=0})$$

The time variable in the expression above, t , denotes whether the observation was before (0) or after (1) the CFIUS excepted statuses were announced. The x variable refers to whether the group is the treatment group (1) or the control group (0). In terms of this study, the above expression would read: the change in the average cumulative abnormal return (CAR) generated after an M&A announcement for treatment countries before and after they were given CFIUS exemptions minus the change in the average abnormal return for the control group over the same time period:

$$\left(\frac{\sum_1^n CAR}{n} \Big|_{t=1,x=1} - \frac{\sum_1^n CAR}{n} \Big|_{t=0,x=1} \right) - \left(\frac{\sum_1^n CAR}{n} \Big|_{t=1,x=0} - \frac{\sum_1^n CAR}{n} \Big|_{t=0,x=0} \right)$$

Utilizing a difference-in-difference methodology is advantageous because it allows us to adjust for both cross-sectional as well as temporal factors. That is, we are able to assess the impact of the Excepted Foreign State designations in 2020 for the treatment group against the control group while also being able to ‘control’ for time. For example, much

of the post-period ($t1$) observations, or transactions occurring after the Excepted Foreign State designation policy went into effect, were situated in the context of the COVID-19 pandemic and its aftermath. The difference-in-difference methodology allows a comparison to be drawn which quiets out any noise which resulted from this. This allows us to get much closer to isolating the true effect of the Excepted Foreign State designations on CARs.

The difference-in-difference is also calculated using the ordinary least squares (OLS) regression below. Doing so is advantageous as it provides a standard error around the estimate. It models the effects of being in the post-treatment period ($t1$ indicates a transaction that occurs after the CFIUS excepted status policy went into effect in 2020) and being in the treatment group ($treatment$ indicates whether the acquirer nation is the U.K., Canada, or Australia) on cumulative abnormal returns, where the coefficient on the interaction term is the difference-in-difference result (β_3).

$$CAR = \beta_0 + \beta_1(t1) + \beta_2(treatment) + \beta_3(t1 : treatment) + \varepsilon$$

C. *Cosine Similarity*

In the context of this paper, cosine similarities allow us to evaluate how similar foreign states' FDI review regimes and legislation are to that of the United States. This is an important investigation since CFIUS awarded the Excepted Foreign State designations to the treatment countries on the basis that these "foreign states have established and are effectively utilizing a robust process to analyze foreign investments for national security risks."²² Consequently, it is worth considering whether any similarities between American

²² *Determination Regarding Excepted Foreign States* 87 FR 731 (January 5, 2022)

and foreign FDI legislation could potentially be a factor that CFIUS considers when making decisions on the ‘robustness’ of other countries’ foreign investment regimes. In other words, could similarity to the American FDI regime be a factor that goes into offering an Excepted Foreign State designation? Cosine similarities between all of the following were calculated:

- FINSA (United States)
- FIRRMA (United States)
- Investment Canada Act (Canada)
- Foreign Investment Reform Act (Australia)
- National Security and Investment Act (United Kingdom)
- Foreign Trade and Payments Act (Germany)
- Procedures for Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security [No. 57-FZ] (Russia)
- Foreign Investment Law of the People’s Republic of China (China)

The inclusion of both FINSA and FIRRMA as relevant FDI legislation for the United States aims to gain an understanding of how similar the update to CFIUS in 2018 was to the legislation that had been in place for the 11 years prior. The inclusion of Canada, Australia, and the United Kingdom represents the treatment countries which were awarded Excepted Foreign State statuses. Germany was included to act as a U.S. ally control and Russia and China were included to act as non-U.S.-ally controls. Determinations for which controls to include largely depended upon availability of English versions of a country’s FDI review legislation.

While this analysis was done using Python, the general form of how this is calculated is presented on the next page for reference. The dot product acts as a metric for similarity

here, the value of which will be large when the two vectors have values which are large in magnitude and similar in dimension.

$$\text{cosine}(v, w) = \frac{v \cdot w}{|v||w|} = \frac{\sum_{i=1}^N v_i w_i}{\sqrt{\sum_{i=1}^N v_i^2} \sqrt{\sum_{i=1}^N w_i^2}}$$

III. RESULTS

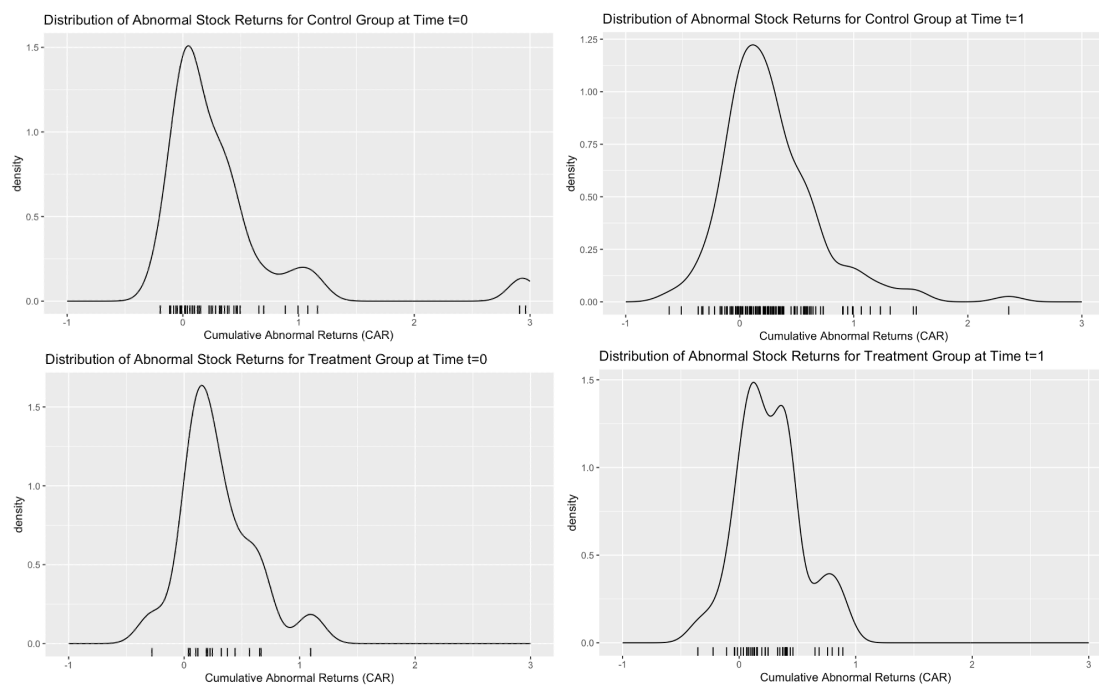


Figure 2: Cumulative Abnormal Return Distributions

Figure 2 (above) shows the distributions of CARs across the four difference-in-difference groups. The rug plot along the x-axis displays the number of observations in each group as well as any outliers. The x-axis indicates the CAR value (for example, 1 = 100% and 0.5 = 50%, etc.) whereas the y-axis displays the probability density of each CAR level.

Table I: Summary Statistics of Difference-in-Difference Groups

Group	Time Period (t)	Mean Cumulative Abnormal Returns	Number of Observations (n)
Treatment: Excepted Foreign States as of 2020	Post-Treatment (t=1)	26.59%	44
Treatment: Excepted Foreign States as of 2020	Pre-Treatment (t=0)	28.74%	18
Control: All Non-Excepted Foreign States as of 2020	Post-Treatment (t=1)	27.58%	127
Control: All Non-Excepted Foreign States as of 2020	Pre-Treatment (t=0)	34.33%	49

Table II: Difference-in-Difference Result

$\left(\frac{\sum_1^n CAR}{n} \Big _{t=1,x=1} - \frac{\sum_1^n CAR}{n} \Big _{t=0,x=1} \right) - \left(\frac{\sum_1^n CAR}{n} \Big _{t=1,x=0} - \frac{\sum_1^n CAR}{n} \Big _{t=0,x=0} \right)$		+4.59%
Regression Output		
	Estimate	Std Error
(Intercept)	0.3432	0.0638
t1	-0.0674	0.0751
treatment	-0.0558	0.1232
t1:treatment	0.0459	0.1459

Considering the standard errors, the 95% confidence interval around the difference-in-difference estimate is [-0.240, 0.332]. The large standard error and the lack of strong statistical significance on the difference-in-difference term may, at first sight, suggest that the market is not aware of and/or not adequately pricing in the different CFIUS foreign exception statuses.

However, the standard error could, and is most likely, merely capturing the fact that there are not enough observations. That is, while the true value could be 0 or even negative, the best guess is that the true value is a positive CAR (the substantial 4.59% estimate) and that the lack of statistical concreteness around the coefficient could be due to issues with the availability of data.

Additionally, abnormal returns are incredibly volatile and vary substantially. This could also be what is leading to the large standard error term. As a result, there are too many factors inhibiting us from truly assessing statistical significance due to the large

amounts of variability in abnormal returns within the sample (see Figure 2). As a result, if future research wishes to truly understand the statistical significance of the policy, a substantive additional amount of data is necessary. Until then, the 4.59% estimate provides the field with the best assessment of the impacts of CFIUS Foreign Excepted Entity designations on market returns post-M&A-announcement.

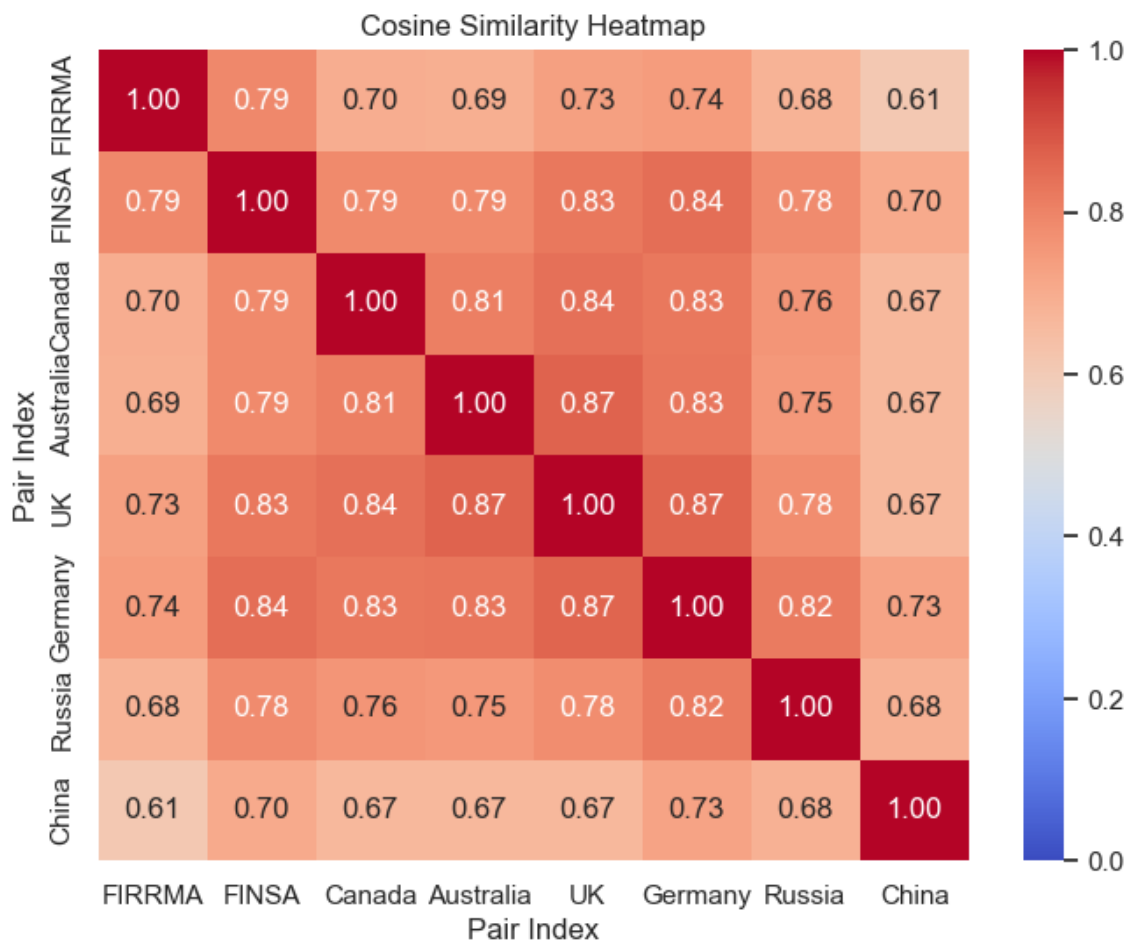


Figure 3: Cosine Similarity Matrix Between Various Countries’ FDI Review Legislation

When compared to both FINSA and FIRRMA, there appear to be strong similarities with the FDI legislation of the treated countries. While this initially seems like a meaningful finding, as a way to pressure-test this, the study also includes Germany, Russia, and China as controls. Germany is included to act as a non-treated U.S. ally whereas Russia and China are included to act as non-treated non-allies. When factoring in these countries, it's clear that there appear to be no meaningful differences in similarities for treated countries and non-treated countries. The unintentional finding of a 78% cosine similarity between Russia's Procedures for Foreign Investments (No. 57-FZ) and the United States' FINSA is noteworthy and will be discussed further in the Conclusion.

IV. CONCLUSIONS, LIMITATIONS, AND FUTURE CONSIDERATIONS

My best estimate is that the Excepted Foreign State designation by CFIUS appears to generate higher returns for U.S.-target firms in the post-M&A announcement period (by about 4.59% on average). While this estimate is subject to substantial uncertainty, this paper proposes a novel methodology which can be replicated once additional data become available in the future. It also signals that CFIUS should consider how and when they add entities to this list. If it is beneficial to American firms, should additional U.S. allies (France or Japan, for example) be added at some point as well? And if the criteria for adding countries to this list is based on the robustness of their FDI regimes, and if cosine similarities don't seem to be a strong indicator, how is this 'robustness' being measured by CFIUS then?

Furthermore, the exploration of cosine similarities among the texts of FDI legislation between the United States and the treatment countries reveals strong similarities. However, when adding Germany, Russia, and China to the analysis, the matrix becomes a bit less

intuitive and a bit more peculiar. Perhaps there are no meaningful differences in the structures of FDI legislation across different regimes. However, this is not to say that the cosine similarity matrix is not meaningful; in fact, it may indicate that many FDI review systems across the globe are based off of one another. This is not entirely unprecedented nor unreasonable. Chinese bankruptcy codes, for example, are largely based on those of the U.S. and incorporate many of the same structures as U.S. bankruptcy codes do,²³ resulting in textually similar regimes though vastly different implementations in practice. In the case of the niche this paper explores which is FDI regulation in a national security context, it makes sense that many regimes will use similar words. Looking at most frequent words across the legislation corpus used in the cosine similarity matrix, the words “transaction”, “foreign”, “person”, and “security” appeared across several different regimes, for example. The 78% similarity between FINSA and Russia’s legislation should also be noted and can support this theory. FINSA was passed in 2007 and the Russian legislation analyzed in this paper was enacted just one year later in 2008.

Nonetheless, the analysis should be replicated, perhaps using smaller subsets of the legislation that make for stronger 1:1 comparisons. Special consideration should be paid to the ways in which legislation may be translated into English and the potential confounding effects of that. Given that the main analysis in this study was the event study/difference-in-difference, this paper did not aim to refine the cosine similarity matrix further. Rather, its intention was to open the discussion of using this analysis more robustly in future considerations of CFIUS and foreign exemptions to FDI regimes.

The role of SEC disclosure is also a valuable topic for future research which may wish to calculate cosine similarities among select SEC filings for publicly traded companies

²³ *China’s New Enterprise Bankruptcy Law*, Kirkland & Ellis LLP, October, 2006

which disclose CFIUS proceedings. In any case, the finding that there is potentially a non-trivial impact of CFIUS exemptions on U.S. stock prices post-M&A-announcement may warrant a discussion on whether CFIUS-related events should be mandatory disclosures for companies listed on U.S. exchanges. While this consideration is beyond the scope of this paper, briefly, it would be important to factor in the SEC's 5% materiality threshold. It has been understood that omitting information from disclosures is immaterial if it affects less than 5% of the firm's total assets.²⁴ Do CFIUS investigations affect 5% of a firm's assets? Even more specifically, does the distinction between engaging in a deal with an Excepted Foreign State versus not affect 5% of a firm's assets? Even if not, there are suggestions that "[e]ven where a misstatement or omission may be quantitatively small compared to a registrant's firm-wide financial results, its significance to a particularly important segment of a registrant's business tends to show its materiality."²⁵ Another potentially fruitful extension would be to conduct a cosine similarity analysis on SEC filings which make note of CFIUS explicitly and/or discuss regulatory barriers to a pending merger or acquisition. For example, do companies which are transacting with Excepted Foreign States report in similar ways as other companies which are also transacting with Excepted Foreign States? Are there noticeable differences between these companies and those which are transacting with a non-excepted entity? Could a sentiment analysis be conducted to identify whether companies engaging with Excepted Foreign States view the deal with greater optimism?

It is also worth noting that the distributions of the data in Figure 2 highlight the existence of outliers. Future researchers willing to build upon this study may wish to consider using the median as the measure of central tendency as opposed to the mean. Alternatively,

²⁴ Charles Rogerson, *The Second Circuit Casts Doubt on 5% Materiality Guideline*, *Berkeley Law* (2012)

²⁵ *Id.*

applying fewer constraints on the M&A data from the SDC Platinum database, should doing so be justifiable, would allow for a larger number of observations and potentially a way to achieve a higher degree of statistical significance.

On a similar note, the difference-in-difference this study uses was limited to a comparison between treated versus non-treated countries. Ideally, future extensions of this work would define several more granular control groups to compare against. For example, some meaningful control groups may be other U.S. allies which are not in Five Eyes (such as Germany or France) as well as adversary countries (such as China or Russia) to see how the cumulative abnormal returns for Excepted Foreign State transactions compare against these. As mentioned earlier, these results were not included because filtering the control to these smaller groups would severely hinder the number of observations available for the analysis beyond the already-scarce amount. This may be an issue that can only be resolved with time, however. Given that the Excepted Foreign State lists are relatively novel, there are less than four years of available data to assess the treatment groups on. As additional M&A data becomes available, this study can be replicated, likely with a greater degree of statistical significance.

Another worthwhile extension may be to shift the time frames used in this study. For example, while this paper looked at transactions post-FIRRMA only, future research may wish to see how M&A transactions which involved countries which were given Excepted Foreign State treatment in 2020 were received by the markets prior to FIRRMA versus post-FIRRMA. Evidently, there is no shortage of questions that can be asked relating to CFIUS and foreign exemptions to FDI oversight in the United States.

CFIUS has historically been a relatively opaque federal regime. While they produce an annual report to Congress, very little specific information regarding their machinations

makes its way to the American public. While the need for secrecy is understandable, the value of transparency in such a consequential regime should not be lost. While this research just begins to scrape the surface of potential questions which could be asked of CFIUS and FDI regulation more broadly, the answers to some of which could likely be pursued with greater time and resources, it is hopefully enough to motivate further discussion and raise awareness among academics and general readers alike, especially when the regime's decisions may have implications for the stock prices of American firms.