WHITE & CASE

Securing investment: FDI screening and the mining & metals sector

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In the world of shifting geopolitical tensions and supply chain vulnerabilities exacerbated by the COVID-19 pandemic, the push for mineral & metal security is changing the way governments, regulators, sector participants and lenders evaluate foreign investment. **David Bond, Rebecca Campbell, Farhad Jalinous** and **Damien Nyer** discuss how the steady rise of national security-related considerations in investment globally expose the high stakes in the race to reindustrialize and safeguard critical supply chains.

National security is not the only driver of stricter surveillance on foreign direct investment (FDI) flows, nor are policy instruments or screening investment approaches uniform in their effect. But the pursuit of "mineral security" and political backlash against perceived unfettered investment have led to competing pressures for mining & metals firms at the heart of the industrial economy and energy transition.

Screening mechanisms

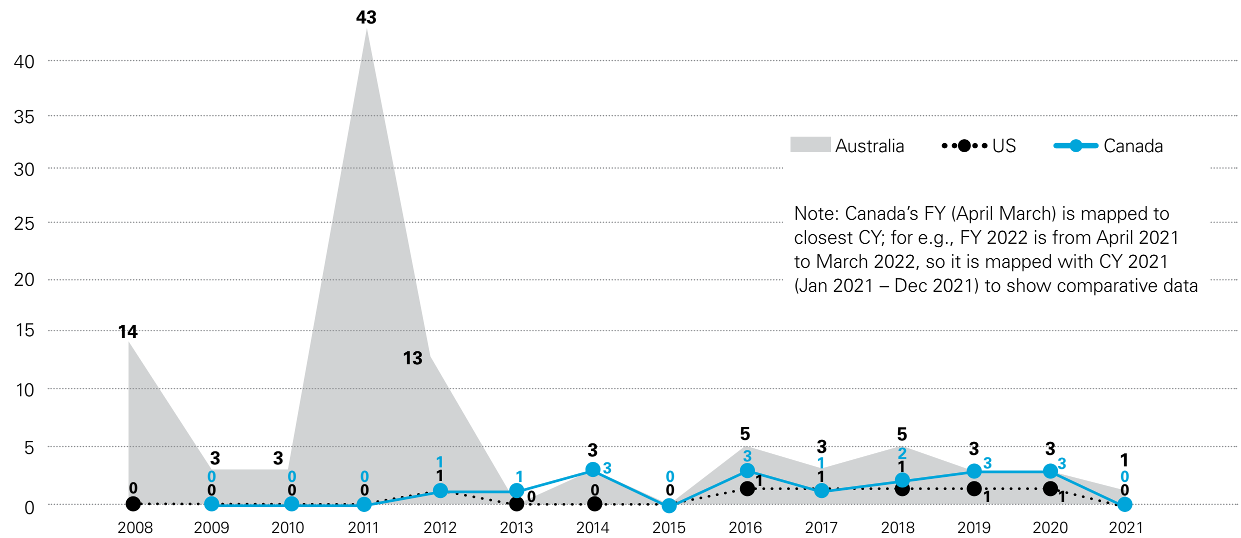
States' approaches and their individual capacity to screen investment varies significantly by geography, level of economic development and political needs. Developed markets with large mining & metals sectors such as the United States, Australia or Canada have universal regulatory screening programs for inward investments from abroad. These programs target specific industries and sectors, as well as establish broad legal catch-alls that regulators apply when reviewing a project. Some developing markets such as Indonesia, Malaysia and Brazil use only industry-specific mechanisms based on the relative salience of a sector. Mining & metals often feature prominently in countries reliant on mineral exports. It does, however, remain the case that many countries have no effective FDI screening mechanisms, as is broadly the case in Africa and most of Latin America.

36.5%

FDI into metals & minerals projects increased by 36.5% between 2020 and 2021

Source: Global FDI Annual Report 2022, Global Data's Investment Monitor

Number of deals blocked by FDI screening



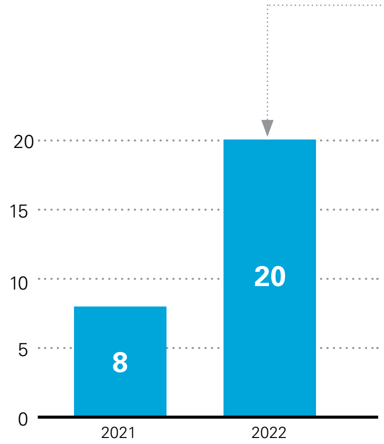
Source: The Committee on Foreign Investment in the United States (CFIUS), FIRB, Investment Canada Act (ICA)

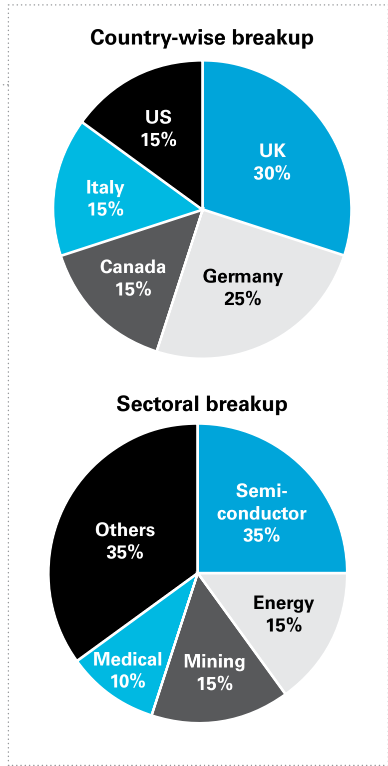
Screening investment on economic security grounds—as compared to more traditional notions of national security, such as weapons supply and infrastructure—is now in fashion due to political and market concerns about the over-concentration of critical supply chains in specific countries. The more concentrated a supply chain, the more disruptive changes in national policy or external shocks like COVID-19 pose for companies and consumers concerned about the reliability of access to necessary inputs and potentially large swings in prices for key goods.

The quest for supply chain security, broadly conceived, has generated momentum in the US to use both executive orders and legislation to create a screening mechanism for outbound FDI from the US. Treasury Secretary Janet Yellen noted in a speech on economic policy on April 20, "we are considering a program to restrict certain US outbound investments in specific sensitive technologies with significant national security implications." Similar changes are afoot in Europe, where the President of the European Commission Ursula von der Leyen has announced intentions to introduce a targeted outbound investment screening mechanism. "Where dual purposes cannot be excluded or human rights might be implicated, there will need to be a clear line on whether investments or exports are in our own security interests." Transatlantic approaches reflect policy trends pushed forward by the sanctions regime applied to the Russian economy and other shifting US foreign relations, which risk spilling over into the mining & metals sector as control over battery IP and renewables supply chains become more salient security concerns.

China's dominant position as a metals refiner and manufacturer for renewable energy and electric vehicles creates persistent risks that specific minerals or metals deemed vital for national security fall under heightened scrutiny for both inbound and outbound investment. These pressures are pushing Chinese refiners and manufacturers to seek their own FDI opportunities abroad in markets with preferential trade access to the US and Europe to get ahead of policies denying Chinese firms access to tax credits and similar support measures in G-7 markets. Huayou Cobalt is one of the most recent examples, signing multiple MOUs with Korean industrial conglomerates. Electromobility giant BYD has sought government support for investments into a lithium cathode plant and potentially a new lithium mining project in Chile since last year. The process has been complicated by the recent changes to the legal requirements governing the lithium sector, but speaks to persistent interest in building processing and refining capacity outside of China in markets that have trade agreements with the US.

Number of deals blocked by FDI screening globally (2022)*





Note: *It is possible that some deals were not included in this list, due to FDI screening, which have not been made public; FIRB: Foreign Investment Review Board

Source: Ion Analytics, HK Law, *Global Competitive Review*

> **We are considering a program to restrict certain US outbound investments in specific sensitive technologies with significant national security implications**
>
> *Janet Yellen, US Treasury Secretary*

Onshoring value chains

Mining & metals markets are highly cyclical, creating parallel political cycles whereby mineral exporters take advantage of tighter supply conditions and higher prices to retain more of the value chain. Businesses need their minerals and have limited means to resist requirements to invest in beneficiation, processing, refining and, in some cases, manufacturing facilities.

Indonesia, the world's largest source of mined nickel, is a classic example. Indonesia progressively banned the export of nickel ore between 2009 and 2019. The move forced foreign partners dependent on supply from Indonesia to invest directly into beneficiation, processing and refining operations, creating further opportunities for investment in nickel-intensive metals production and manufacturing. Indonesia has historically limited any foreign investment into specific industries through blanket bans or limits on foreign ownership rather than screening investments individually. Instead of screening FDI through a strictly security lens, policies requiring more investment into post-extraction processes create new competitive advantages or preferences for certain companies based on their portfolio's geography, market profile, past experience in Indonesia and relevant experience elsewhere to enter projects.

Other countries are adopting similar approaches to cash in on the critical minerals boom. As of early June, the Namibian government has reportedly restricted exports of unrefined lithium for future project licenses, narrowing the window for ore exports to the early stages of a project, when miners typically need to recoup costs quickly. Chile launched a "soft" nationalization of its lithium sector on April 20, imposing requirements that all future projects be majority-owned by a state-owned vehicle managed by Codelco and that future projects use direct lithium extraction (DLE) to minimize water use in the Atacama Desert. Beneficiation, "soft" nationalization, and other requirements are becoming an increasingly common tool for countries to retain more of their mineral wealth and counteract potential losses from onshoring policies elsewhere.

This approach can backfire, particularly in cases where a country is competing with a larger pool of exporters for market share, has yet to extract a mineral at scale commercially, and adopts an overly aggressive nationalization strategy. Bolivia is a cautionary tale. Despite holding the world's largest estimated lithium reserves, the decision to fully nationalize the sector under state control more than a decade ago has left Bolivia almost entirely out of the lithium value chain. Only miners willing to accept the high level of risk have taken part in recent state-supported pilot projects, and none had any prior experience mining lithium on a commercial scale. As yet, no major commercial projects have been developed, though battery giant CATL has announced plans to invest as much as US$1.4 billion into two lithium plants using DLE technology that may begin development in the months ahead.

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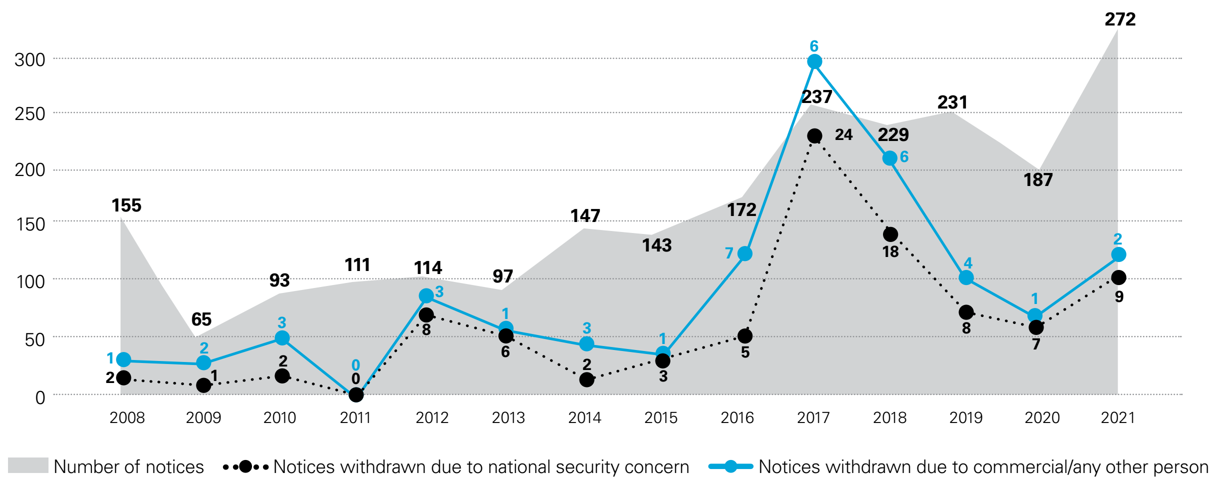
Greenfield metals & minerals FDI projects globally in 2021

Source: GlobalData's FDI Projects Database

Number of total notices/screening proposals and withdrawals in the US*



Note: *Includes only those withdrawals that were not refiled and are considered abandoned deals

Source: CFIUS

Navigating re-emerging risks

Mining & metals firms must contend with new extra-territorial risks, as the policy toolkits deployed by governments to shape investment flows expand. At the beginning of November last year, the Canadian government ordered Chinese firms to divest from Canadian junior lithium miners Neo Lithium Corp., Power Metals Corp., Lithium Chile Inc. and Ultra Lithium Inc. The order was unprecedented considering the Canadian miners in question owned assets in Chile. They fell under the purview of investment controls because they were listed on the Toronto Stock Exchange. The decision has unleashed new kinds of uncertainty for miners who have historically sought to raise financing by publicly listing shares in leading financial centers, an approach governments are increasingly willing to leverage.

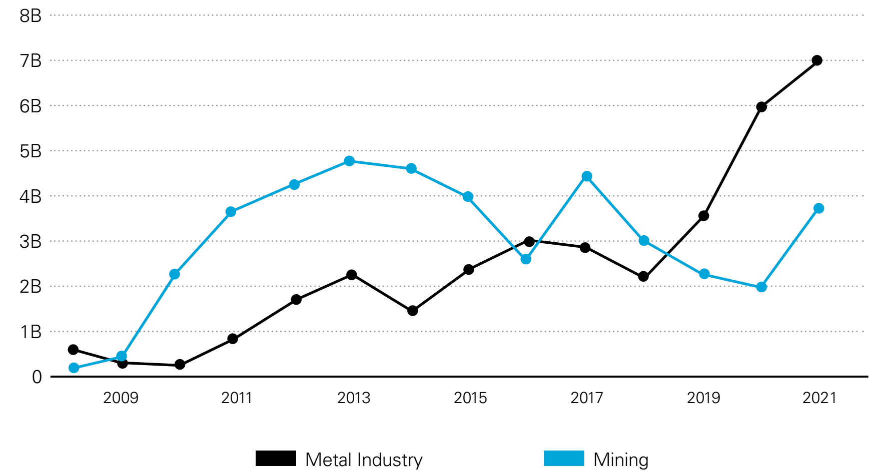
Potential risks from foreign listings are compounded by heightened counter-party scrutiny. Governments are increasingly wary of allowing firms to partner with foreign companies from countries deemed to pose security risks or otherwise occupying a commanding share of an important market. Commercial arrangements perceived to afford competitors a significant degree of leverage over a key company give rise to the same concerns addressed through expanding controls on FDI.

All of these factors depend heavily on the demands placed on national governments. Countries desperate for fiscal revenues and export earnings are unlikely and/or unable to be so demanding, as developed markets are seeking to shift critical minerals and metals supply chains onshore or into the hands of allies and friends. Similarly, mineral exporters with large shares of the market for critical minerals, such as nickel, copper, lithium, manganese and cobalt, have considerably more leeway to impose conditions on FDI in support of political objectives.

Mining & metals firms have considerable opportunities amid these trends. By being nimble and staying a step ahead of the market's twin price and political cycles, companies can flip the risks created by tightening screening mechanisms into opportunities by entering new markets and shifting midstream and downstream supply chains accordingly.

Foreign direct investment in Indonesia

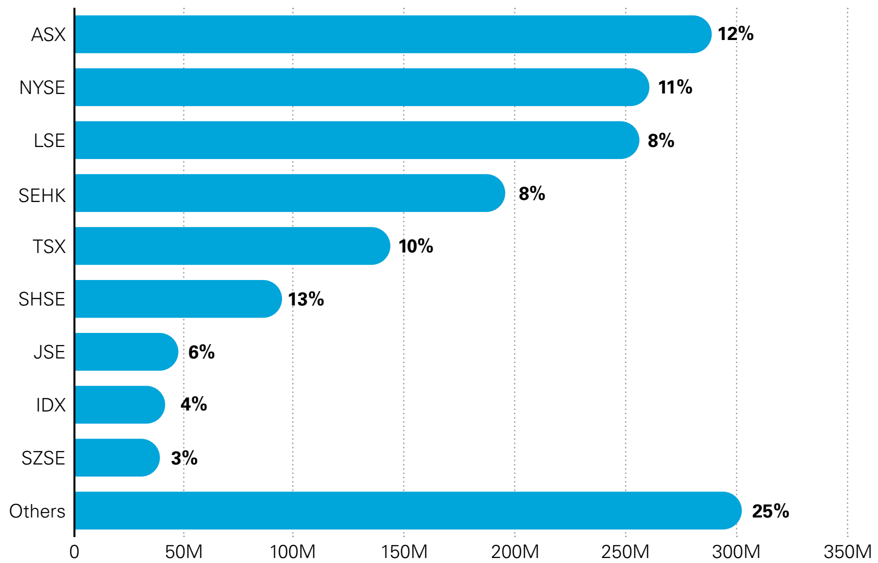
Investment (US$ billion)



Source: Indonesia's uncertain climb up the nickel value chain | Lowy Institute

Top-100 mining companies by most popular exchange, with cumulative market cap value per exchange

Market cap value (US$ million)



Source: Own analysis, White & Case

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