



Foreign Affairs Committee

Oral evidence: The FCDO's role in blocking foreign asset stripping in the UK, HC 296

Tuesday 23 February 2021

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Members present: Tom Tugendhat (Chair); Neil Coyle; Henry Smith, Royston Smith; Graham Stringer.

Questions 299-324

Witnesses

I: Michael Formosa, Managing Partner, Renaissance Strategic Advisors; Dr Ashley Lenihan, Fellow, Centre for International Studies, London School of Economics.

II: Paddy McGuinness, Senior Adviser, Brunswick, and former Deputy National Security Adviser for Intelligence, Security and Resilience.

Written evidence from witnesses:

– Dr Ashley Lenihan:

<https://committees.parliament.uk/writtenevidence/5787/pdf/>



Examination of witnesses

Witnesses: Michael Formosa and Dr Ashley Lenihan.

Q299 Chair: Good afternoon and welcome to this afternoon's session of the Foreign Affairs Committee. We are looking specifically at asset stripping, how foreign purchases affect the integrity of the UK economy, and what the National Security and Investment Bill, and other aspects of changing policy, will do to protect UK investments and maintain the UK's openness to international foreign direct investment.

This afternoon we are very lucky to have two sessions. The first session will be with two witnesses—Dr Lenihan and Mr Formosa. I will now ask them to introduce themselves.

Dr Lenihan: Hello. My name is Dr Ashley Lenihan. I am a fellow at the Centre for International Studies at the London School of Economics. My research, for the better part of 20 years, has focused on national security and foreign investment.

Michael Formosa: My name is Michael Formosa. I am managing partner with Renaissance Strategic Advisors, an aerospace and defence consultancy that concentrates on trade and investment issues, among other things.

Q300 Chair: We are looking specifically at the National Security and Investment Bill, which was published only a few weeks ago, and which you have no doubt found as interesting as we have. When it comes into force, what will be needed to make sure it is implemented effectively? Where should the Foreign, Commonwealth and Development Office be contributing to this? Dr Lenihan, perhaps you would like to start us off.

Dr Lenihan: Of course. The Bill is a welcome and important step towards protecting UK national security in the context of foreign investment, and towards greater alignment with its allies on this issue. That being said, the Bill is so comprehensive in its efforts to address potential threats that it does not limit coverage to foreign investors alone, meaning that it is likely to see a far higher volume of notified investments in the first few years than is usual for most review regimes of this type. With that in mind, there are two things that I would highlight to ensure its effective implementation once it is enforced.

The first is very clear implementing regulations and guidance notices, outlining some of the parameters that are likely to be used by the Government when assessing national security risk. In line with best practice from other countries that provide that kind of guidance, such as the US, Australia and Canada, it should be illustrative, not exhaustive, for the very same reasons that a definition of national security is not included in the Bill itself. The FCDO should, of course, be consulted in the final formulation of the guidance, to ensure that it is in line with UK foreign policy, current geopolitical concerns and the UK's treaty obligations.



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The second and perhaps more important thing that I would like to see is that the Government will need to ensure they have the proper resources and institutional capacity in place to support the powers that are provided for in the Bill. A key element of this will be ensuring that there is a regularised and consistent feed-in mechanism from Departments across Government, including the FCDO, the MOD, the Home Office, the intelligence services and other relevant Ministries. Their expertise will be needed both to help assess national security risk and to assist in monitoring for non-notified investments of concern.

The FCDO is uniquely placed to provide assessments of the national security risk associated with a potential investment. It has a unique knowledge base and access to information on a variety of state and non-state global actors, which makes it well placed to understand the risk posed by a particular acquirer or a trigger event, and to then place those acquirers and trigger events in the context of their countries' economic and foreign policy, strategies, actions, history, global power dynamics and current points of friction. The FCDO, along with other partners and Departments, should be crucial players in flagging trigger events that might not necessarily appear on the Government's radar through the monitoring of traditional databases and repositories. One cannot overestimate the importance of built-in redundancy when it comes to catching investments for call-in and review. The FCDO, as I said, will be well placed to help monitor for such trigger events, not only because of its consular activities and foreign post intelligence, but from its own investment and trade activities. Organisations such as GCHQ and its new cyber unit would also be particularly well placed to help that kind of monitoring.

This is the last point I will make here so that Michael can answer as well. To put things in perspective, for many other regimes that we might consider benchmarks or bellwethers, they reported a sharp increase in the volume and complexity of strategic foreign investments that they have needed to review in recent years—the US, France and Germany in particular. If we take the US case, for example, a key provision of the Foreign Investment Risk Review Modernization Act of 2018—FIRRMA—was to provide for greater funding and staffing because of that increased volume and complexity of cases that was coming before the Committee on Foreign Investment in the United States (CFIUS). That has to be considered in a context where CFIUS already has dedicated representation from nine separate Government Departments, five observing offices and two ex-officio members at their meetings (including the Director of National Intelligence). They reportedly had 91 dedicated staff members in 2016, the same year that they had only 172 notifications for review. We expect that the investment scrutiny unit within BEIS will have about 100 people, from the statements that have been made, but the Government expects that they are going to have an estimated case load of 1,000 to 1,830 notifications per year. That is a lot of ground for one team to screen without having the benefit of dedicated points of contact and staff in other Departments who are fully there to help feed into that review and that monitoring process.



Q301 **Chair:** Thank you. Mr Formosa, your perspective on this is slightly different. Perhaps you can address it from your own take?

Michael Formosa: From my take, I actually agree with many of these points. I think that enforcement is really going to be very labour intensive, in terms of continually monitoring IFDI activity, flagging potential issues, adjudication, and so on. Plus, there is a whole other activity that really needs to take place regarding the synthesis of the activity, so that over time we can refine, and ultimately evolve, the process in line with needs as they arise. The Foreign Office really has a crucial role to play in all of this, and I see at least three opportunities.

First, as value chains become increasingly complex and our trade and investment relationships evolve post-Brexit, we need to understand the various entities with whom we are doing business—the nature of their ownership and their tertiary geographical footprints and key enabling technologies, meaning not only those they are dealing in at the moment, but those they are aspiring to. Obviously, the Foreign Office's footprint, perspective and experience in these countries can go a long way towards shedding light on these issues and more.

Secondly, we need to understand, more generally speaking, the legal systems and the trade investment regimes in partner nations, in order to understand how they match up to our own. Are they complementary? Are they more restrictive? Or are they completely freewheeling? This is especially important in the defence and security space, where the United Kingdom is now currently being forced to consider the viability of working with collaboration partners in order to develop and produce the next generation of military hardware. A case in point is the possibility of a sixth-generation fighter, where we absolutely need to collaborate with partners. Here, it is particularly important to understand not only the nature of foreign involvement in our own supply chain, but that of our partners as well.

Thirdly, and more generally, I would argue that, given the fact that embassy staff aren't exactly siloed—namely defence, military, trade and investment, and diplomatic staff—the Foreign Office can play a role in the co-ordination and facilitation regarding the multitude of ways in which BEIS, DIT, MOD and others might have to co-ordinate around specific foreign direct investment opportunities.

All of this really leverages the FCDO's strengths having to do with their presence in other countries. They have been in these countries forever and they can pick up on a lot of the cultural aspects. They can explain why a country wants what it wants, why they do what they do, and how we've come to this particular point in time, based on a very long perspective and knowledge.

Chair: Thank you very much indeed. You've touched on the pitfalls for implementation; as the FCDO addresses these, I know that there are many different areas that we could learn from. On that basis, I will hand over to Graham as I know he wanted to ask about another countries.



Q302 **Graham Stringer:** Thank you. Can I ask Dr Lenihan how the UK's foreign investment regime compares internationally? You've given us one comparison, but how does it compare to other countries? Is it better, worse, or mid-ranking?

Dr Lenihan: That is a very good question. Across the 62 regimes that the OECD monitors on this issue, roughly about 47, plus the EU, have some sort of mechanism like this to protect strategic and sensitive assets. Each country has, necessarily, a unique approach to this process, because they are tailored to their different geopolitical, economic and domestic contexts. That being said, there are some trends and similarities that we can see, and we can try to understand the proposed regime in that context.

Many countries use a blend of cross-sectoral and sector-specific reviews, like the one proposed in the UK law. That seems to work best, from my own observation, in catching cases and when dealing with large economies with large amounts of FDI. Countries that do that include the US, Germany, Australia and even China. In many countries, cross-sectoral review regimes use, as their co-ordinating body for the day-to-day administrative process of handling the regime, a Business, Treasury or Trade Department, again as proposed in the UK law. That seems to be in line with practice.

Some differences with the UK regime are important to highlight and we need to think about them. Many large economies—again with high levels of foreign direct investment—have some sort of system for regularised input from their Ministries and Departments across sectors. In a number of those countries with cross-sectoral reviews, those Departments tend then to make a recommendation to a higher governmental authority, which decides whether that investment should be allowed, mitigated or blocked. In the US, it is the President; in Canada, it is the Governor in Council; in Germany, for their cross-sectoral review, it is the Federal Cabinet, including all its Ministers, who make that kind of decision.

Like the UK, many countries are amending their legislation and creating new regimes, because of changes around sensitive data and emerging technologies and, in the context of covid, because of concerns about the security of supply chains, biotechnology and other areas of the health sector. They are also trying to tackle increasing strategic investments in real estate near sensitive assets, in insolvent sensitive assets, which is very difficult to track, and more assertive greenfield investments in key sectors. A lot of them have realised that thresholds for investment do not seem to be practical anymore because, often, investments of concern are non-controlling investments. It is good that the UK regime is moving in that direction, and I think that the Bill is very comprehensive in the sense of trying to tackle those issues.

Another thing to think about when comparing regimes is that many countries, including most EU countries—which we might consider similar to the UK in many ways—have additional mechanisms to protect their strategic sectors and assets from vulnerability outside these review regimes. A number of them have state ownership of companies in



strategic sectors—I don't think that the UK is likely to return to, or go in that direction—or they have reintroduced golden shares and powers in strategic assets in recent years. The one that is of most interest, and that a number of countries are increasingly introducing, is domestic sovereign wealth funds to help absorb vulnerable strategic assets when a favourable white knight cannot be found as an alternative investor. France and Germany have sovereign wealth funds like this, which they have been active in using recently. The UK has considered that in the past, but I think the financial assistance portion of the Bill actually plays a similar role and might preclude the need for that kind of similar mechanism.

The other thing that I would point out in response to this question and to the pitfalls question is that a lot of countries are increasingly trying to improve their systems for monitoring non-notified investments, again in an effort to catch those before the damage is done. I mention this in my written testimony, but in the US, for example, in a number of cases, member agencies contributing to the CFIUS process caught a suspect investment after the fact. In 2010, for example, Huawei had acquired advanced computing technology assets from a then insolvent and bankrupt 3Leaf Systems. The parties did not voluntarily notify CFIUS. Instead, it is understood that the transaction was brought to the committee's attention by an astute governmental employee who had been looking around on LinkedIn and realised that one of 3Leaf's founders now worked for Huawei. So, CFIUS retroactively reviewed that transaction, found it to be a risk to national security and forced divestment.

A number of countries are increasing their monitoring efforts. France, for example, has introduced a new unit, the Strategic Information and Economic Security Service, or SISSE, which draws on a nationwide network to detect transactions of interest. CFIUS reportedly has a new SWAT team, which is looking into previously non-notified transactions, especially by venture capitalists in strategic sectors, especially the tech sector, that might have had Chinese funding. That is the kind of thing that highlights the need for regularised feed-in from multiple Government Departments, and the need for constant monitoring of the kind that the FCDO is very well placed to assist with, just to improve that built-in redundancy.

Q303 Graham Stringer: That is really interesting. This two-part question follows from that: in other countries, is it always the Foreign Ministry that is in the lead wherever they take advice, information, and input from? You mentioned pitfalls—are there bad examples that we should avoid?

Dr Lenihan: Again, a very good question. In countries with cross-sectoral review mechanisms that have high levels of FDI and big economies, it is usually the Ministry of Economic Affairs or a Treasury Department that acts as the administrative review body, with other Ministries feeding into that process. Which Ministries feed into that process to a greater extent depends on the country at hand.

In the US—which arguably has one of the oldest and most institutionalised cross-sectoral review mechanisms, the world's largest economy, and is the



world's largest recipient of FDI—the State Department is a key member of CFIUS; it is represented by the Office of Investment Affairs. The OIA in its normal capacity is charged with protecting national security while maintaining an open investment climate, so they are responsible for a whole host of things, from leading investment agreement negotiations to promoting regional co-operation. In that capacity, they are able to contribute to CFIUS a very broad and deep knowledge of the relevant actors, laws, regulations, investment climates, state policies and active disputes that may pose a risk to particular transaction, and that is a key role.

In Australia, the Department of Foreign Affairs and Trade contributes more on a case-by-case basis to the cross-sectoral investigations that are conducted by the Foreign Investment Review Board, but it is a strategic and very important assessment that they provide. In their own assessment of their role in the FIRB, they point to the fact that their assessments are focused on the character and strategic intent of potential acquirers; that they have a unique knowledge portfolio, like the FCDO; that they have extensive overseas networks, like the FCDO. That helps make sure that not only are these assessments rounded, but also that final decisions are taken in line with Australia's treaty obligations, and that, when possible, suitable mitigation arrangements are found that are acceptable and seen well in the light of certain bilateral relationships.

In Germany, which is the last example I will give, the Ministry of Economic Affairs again leads the review and consults the Foreign Ministry on a case-by-case basis. The important point is that in that cross-sectoral review process, they cannot veto or mitigate any investment without the consent of the entire Federal Cabinet, including the Minister for Foreign Affairs. It is a very important point, because it is a different system from their sectoral-specific reviews, where there is a greater presumption of denial. Therefore, their logic—from the outside anyway—is that Ministers can take those decisions by themselves in their own sector, but when it comes to the whole economy and the whole nation it is important to have that contribution from across government.

I think there is a very strong argument to be made for FCDO involvement in the UK regime. Based on caseload alone, I think it is going to be needed. To put things in perspective, Germany handled about 106 cases in 2018-19; for Australia, we estimate about 275 from the assessments that its intelligence services provided. The US had 231 notifications in 2019. The UK's caseload is going to be much bigger, and it is going to really need that kind of assistance.

Q304 Graham Stringer: On the pitfall question, what is best avoided?

Dr Lenihan: The answer to that is kind of a matter of personal preference. I think different countries would make different arguments about what is best avoided, and what is not. However, in my capacity as someone who has researched this for a very long time, I have argued elsewhere that for a national security investment review regime to fulfil its purpose and still be part of an economy that is open and encouraging to



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benign investment, it is incredibly important not to confuse the issue of national security with economic or job security, or other forms of national interest that might be considered protectionism. I think that has caused confusion for foreign investors in some countries, such as Canada and Australia, and right now, the supporting documents for this legislation seem to show that the Government's intent is to focus only on national security issues in this legislation.

However, I think that given the political undertakings that have been made public in recent years, which often include measures asking acquirers to keep jobs in the UK, it is not surprising that that has been raised as an issue of concern, and I think it would be a big pitfall if this legislation were used for protectionism, rather than for the purposes of national security. That, again, is a place where having input from multiple Ministries and Departments such as the FCDO helps to keep the Government accountable and focused on mitigation measures that are appropriate to secure national security.

Q305 **Chair:** Thank you very much. Henry, I know you wanted to come in. I know you are going to have pressures on your time, so I am going to leap in and ask what other relevant information, beyond the foreign policy and economic diplomacy considerations of foreign investment, the Foreign Office could provide to contribute to the screening process. Is this local knowledge from embassies around the world as much as it is the wider economic question? Perhaps, Mr Formosa, you would like to answer that.

Michael Formosa: The Foreign Office certainly has roles to play beyond foreign policy and economic diplomacy considerations. I would highlight three potential areas, all of which would be focused on the provision of additional relevant information for the screening process. The first is that in actively seeking trade and investment opportunities for Britain, the Foreign Office can go a long way towards qualifying them through a geostrategic lens, but I would include the fact that as technology becomes increasingly advanced, the materials required to build those technologies need to be securely sourced. The Foreign Office needs to help assure the security of our sources as this becomes more of a diplomatic issue, and the more that those sources are remote and in countries that are non-typical trading partners.

The second is about the Foreign Office's veritable army of on-the-ground personnel. I realise that I am really talking about DIT here, but commercial officers work out of the Foreign Office footprint—embassies, high commissions, and consuls general—all over the world. It is this group's job to actively engage industry, academia, S&T institutions, Government Departments and trade facilitation groups, all with an eye on understanding commercial and research activities on a very granular level to further our interests and have a sharp eye on our own prosperity. However, the question is who is collecting and synthesising information gathered by commercial staff, and through what lenses are we actually assessing that information: military, commercial, scientific, and so on? Moreover, is there anybody with the positioning, or even the capability, of



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fusing information from multiple sources—not only within countries, but across countries—such as information from the commercial office and the high commission in country A, versus a vice-consulate in country B?

Finally, I think Ashley referred to this a little earlier, but given the need for very deep and granular investigations into things like ownership, tertiary geographical footprints of entities and technology issues, I believe that the Foreign Office might have—if not at its immediate disposal, certainly within its auspices—the intelligence-gathering and analytical power to very directly feed our understanding of these important issues on an individual basis, and the analytical power that would enable us to synthesise this information in such a way as to enable us to enhance knowledge and enforcement, and to predict the actions of commercial and Government actors. On the one hand, I completely understand that the reality of the dynamic between and amongst the different agendas at play, amongst parties in a given embassy, but I do believe that a greater understanding, even situational awareness on a per case basis, should be the priority.

Chair: Thank you very much. Dr Lenihan, don't feel you have to add if you agree with all the points.

Dr Lenihan: I am just going to say one thing. I agree with everything that Michael has just said, and I just wanted to emphasise that in addition to the kind of commercial regulatory updates that embassies produce and their on-the-ground knowledge, it is that knowledge, of the local economic and political policies that are relevant to a particular transaction, that they have because they are on the ground.

In the case of China, it is being fully aware, for example, of the Chinese national intelligence law and the effect that that has on businesses that are based in China and acting as potential acquirers, and the resulting effect that that might have on a particular investment in very specific sectors and areas. I think that is a really important point and I agree with everything that Michael has just said.

Q306 **Chair:** Thank you. I am going to move on and ask about a new fusion team, because of course we are talking about a shift with this oversight board, with this inquiry team looking into companies. Would a new fusion team within the Foreign Office focusing specifically on national security assessments be something worth doing? What skills and expertise should it be drawing upon?

Dr Lenihan: I think that, at minimum, the most important thing is that there is an established point of contact and representation within the FCDO that reports to the ISU, or at least liaises with the ISU in a regularised fashion. Those key points of contact, whoever they are, need to have security-cleared staff behind them, who can then help perform assessments to support the review process—fully integrated assessments of the type that Michael just mentioned.

Those staff should have some sort of background in finance and finance law or investment and investment law. They should have a keen

understanding of the investment and regulatory climates in the UK's strategic competitors and their key allies, as well as the policies and strategies of those countries. They should have access to expertise and information across the entirety of the organisation. Also, they should be in post long enough to actually establish that type of, as Michael would say, fused expertise, and establish and utilise that expertise, and then be able to pass it on to those who replace them.

What form that takes, whether it is a fusion team or an office or simply as I said a few key designated persons who work across the organisation, I think it is probably best left to the FCDO itself. I am sure Mr McGuinness might have some very good points to make on that front. I think the important point is that that capacity needs to be there in some form and, as Michael has pointed out, that that capacity needs to be able to take a holistic look at these issues from across the knowledge base of that organisation.

Chair: Thank you. Mr Formosa, do you want to come in?

Michael Formosa: Just to make a couple of points. I think we are very well covered with skills. We have got them; they are a given. I think that this obviously creates a very holistic view on a given subject or target, and that is a good thing, but it also has the potential to be a good idea on paper only. What I mean is that I would expect all of these groups to have violently opposing agendas from time to time. Organisational design is really important to make all of this cohesive and effective. It is important to get organisational design right, rather than getting dragged into arguments over where, how or who should own what.

Finally, the question is about whether the team should be within the Foreign Office or not. If its thinking and outputs are ultimately for the Foreign Office then at first glance, why not? A good example of such a group with a specialised aim is the Defence Intelligence Fusion Centre, responsible for more of a multidisciplinary intelligence fusion for the armed forces. That said, the avoidance of duplication and confusion is paramount, because there may be several groups with similar internal centres. On the other hand, if it is for wider aims to which the Foreign Office contributes, I imagine it to be situated more towards the top of the food chain, like the Joint Intelligence Committee which, as we know, reports directly to the Cabinet and the PM.

Chair: Thank you for that. Royston, you wanted to come in.

Q307 **Royston Smith:** May I ask whether there are any examples of previous foreign investments in the UK that would have had a different outcome for the UK if the FCDO had been more involved, for example, in terms of national security, economy or foreign relations?

Michael Formosa: As far as I am concerned, without going down a rabbit hole of specific examples, if I take two steps back I think there are actually two activities. First, when it comes to good old-fashioned inward capital investment, we need to keep in mind that, the last time I checked,



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we were No. 3 in the world, behind the United States and Hong Kong, which seriously means that we might be approaching No. 2 pretty quickly.

Especially in a post-Brexit environment, where we need to take advantage of our G7 market and use it to attract would-be investors, generally speaking, the less Government intervention the better. I said previously that if you introduce regulations where there were no regulations previously, that will act as a handbrake on business.

On the other hand, what is truly important and what needs to be central is the predictability and clarity of whatever regime we put in place, so that would-be investors really understand where they are positioned from an early stage. Where you have uncertainty and where there can be Government intervention at the eleventh hour of an investment, that is where the problems are and where we see some of the comparative differences with, say, the French regime. We looked at a situation with the possible takeover of Photonis, a French producer of optical equipment, some of which is used in the defence industry. Teledyne from the United States attempted a takeover. It was on again, off again, on again, and ultimately a group of parliamentarians was able to exert enough pressure to scupper the deal. That sends a huge message to business that needs to operate on the basis of predictability and understanding where they sit in the process.

When it comes to protecting IP, tech areas that we want to remain sovereign, jobs, skills that we do not want to be off-shored, the Foreign Office can contribute in all the ways that I have suggested and repeated, more simply, understanding the capabilities, motivations, risks, opportunities, et cetera of would-be foreign investors. Perhaps, most importantly, is understanding that these decisions are not always going to be black and white. A lot is going to live in the grey area where perhaps mitigation measures might be applicable and eminently acceptable on the part of the would-be investor.

Q308 Royston Smith: Dr Lenihan, I know you want to come in. Can I push you to give us some examples, if you can? The reason the Government are looking at this legislation is presumably because there are things that they wish they had done better.

Dr Lenihan: I think it is a difficult question to answer. Without being privy to the full extent of FCO and FCDO involvement in the past behind closed doors, and without knowing what warnings they specifically gave or when they were actually consulted, it is a little hard to play quarterback after the fact. What I can say, again, from the perspective of my research, is that I have found certain investments to be truly surprising—that is from the perspective of one who has dedicated much of their life to studying this issue.

The most obvious example is, of course, Hinkley Point C and the fact that any non-allied investor, much less an investor from a strategic competitor, was allowed such a key role in the development of a nuclear power plant. Again, it is hard to know fully whether the FCO would have been listened



to, but that is a well-known case, so I will not belabour that one. Equally, while Gardner seems to have been dissuaded by the Government from pursuing its proposed purchase of Impcross and its owner Ligeance has been dissuaded from purchasing Mettis, it does seem odd from a historical perspective that a Chinese company—whose largest shareholder, as a quick Google search shows, is the State-owned Assets Supervision and Administration Commission of China—was able to buy Gardner in the first place, much less purchase Northern Aerospace in 2018, even with a mitigation agreement.

There is also the Hytera-Sepura acquisition, where Hytera—a company banned from federal contracts in the US over national security concerns, in part because of the laws that they are subject to in a highly sensitive industry, including the national intelligence law—was allowed to purchase a company that provides critical radio services to the UK emergency services. There are others, but, in instances such as the latter especially, one would hope that if the FCDO had been consulted, it would have raised concerns over the purchase of that company in the context of Chinese state policy. Again, I am talking about not just the Going Out strategy, which encourages and supports through financing and subsidies outward foreign investment in strategic sectors specifically to gain a global competitive and technological advantage, but, in a case such as Sepura, the national intelligence law that mandates that all companies, organisations and citizens in China assist in national intelligence efforts, that they must not disclose those efforts and that they will be supported for making them.

Many in the course of this debate have raised takeovers such Cobham, DeepMind and potentially ARM now by US companies, and seem less concerned about takeovers in equally sensitive sectors and companies by foreign companies that are ultimately owned or heavily connected to foreign Governments. Huawei, for example, has made a number of purchases in the UK tech and ICT sector that are rarely mentioned in the course of this debate—I would be happy to provide a list of those offline.

Of course cases such as Cobham should be reviewed and, yes, mitigation measures should be put in place, even for an ally, but the character and strategic intent of an acquirer matters, and the policies and laws of their country of domicile matter. The FCDO will have an understanding of when a deal should be mitigated and when it should be blocked. Yes, we hope that there are more mitigations than vetoes, because the veto should be a very rare tool if it is to be done effectively and you are to maintain an open economy. But again, the FCDO is less likely to fall prey to protectionist arguments or concerns over job security, national champions or other issues that are not about essential security, so it can help that process to work. Does that help to answer your question?

Q309 Royston Smith: It does, and it brings me on quite nicely to other countries. You mentioned that even with an ally, the Government must be careful about what is and is not acceptable, so how do we understand whether the country of origin is in itself a national security risk in a



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transaction, and how should that consideration be weighed against other factors, such as the strategic value of the target entity? How can we know? Some of it is obvious, but some of it may not be.

Dr Lenihan: Again, that is a really good question. Historically, many mitigation agreements have occurred between allies, especially in the aerospace and defence or the technology and telecommunications sectors, but vetoes should only be used for instances of real strategic competitors and competition. I think the idea of a whitelist is something that the UK might want to keep under review. Whitelists are often found in EU countries that use ownership thresholds for the reviews of investments—they lower the threshold of investment for EU, EEA or EFTA residents or nationals—usually in their cross-sectoral, rather than sector-specific, review mechanisms. Portugal, Germany, Lithuania and Estonia, for example, do that kind of thing.

The US recently introduced a kind of whitelist under FIRRMA to exempt certain qualified investors with ties to exempt states from its mandatory notification process for some non-controlling and real estate investments. That status has been given to close allies—the UK, Australia and Canada—and it is going to be reviewed again in 2022. To help answer your question, the reason I raised CFIUS is that they posted guidance on some of the factors that they use when making that decision. They look at things like whether other countries have strong mechanisms for reviewing foreign investment, whether they are legally able to find the ultimate beneficial owner and ask for that information under law of an acquirer in their country, whether they have some sort of arrangement with the US to safeguard national security in the context of foreign investment, and whether they are willing to share intelligence information about foreign investment. Those are the kinds of things they list. Again, I am happy to provide a link to that to the Clerk afterwards.

That works well in very specific instances where it is defined for certain types of investments and you are dealing with what you might consider low-risk allied countries in those sectors. It is very rare to see a complete exemption even for allies from some part of the process. It is something to keep in mind. It helps to maintain flexibility, but to have that kind of whitelist or geographic specificity you really need a regime that can identify ultimate beneficial ownership to make that work. The scrutiny unit is going to have a really high learning curve at the beginning. If a whitelist were to be taken up officially or unofficially, the FCDO could play a big role in helping to identify these actors and the type of criteria used to identify them, because it might be different for the UK than it is for other countries. It is something that I would suggest is done later in a more established regime.

Royston Smith: Mr Formosa, did you want to add anything to that?

Michael Formosa: Yes please. I think that a whitelist is ultimately not viable at this point. A theme of what I have been espousing today is that a lot of these are not going to be black or white situations. Each opportunity needs to be considered on a case-by-case basis and on its own merit. Of



course, we need to consider country of origin and where it sits in terms of our geostrategic objectives and priorities. China keeps coming up in this debate, but is it a state-owned defence firm in China looking to buy into part of our missile value chain, or is it a Chinese investor looking to set up a commercial plant somewhere in Birmingham?

There is even middle ground here, and there are many recent examples out of the United States—most notably the attempted acquisition of a hotel on Coronado Island in San Diego, which basically overlooked a naval base. That was ultimately stopped. We need to understand a lot more detail around what the strategic intentions are, as opposed to merely the country of origin. I have also talked about the entity specifically in question, in terms of ownership, both in terms of the individuals involved and on a national level. It doesn't help if we have a French firm trying to buy a certain UK asset when it is actually just a French shingle owned by somebody in another country. That is not to mention holding companies, sovereign wealth funds, state-owned enterprises and other really complicated ownership structures.

Another thing is the tertiary geographical involvement and influence of the entity in question. Are we looking at its presence on more of a global level and understanding what, in combination, the strategic ambitions are, most notably in the technologies in question? This needs to be considered not only in terms of the technology that they are seeking or possess, but in terms of how such technologies can act as building blocks to something else. In other words, can technology A be used to make commercial product A only, or can it also be used to make weapons-grade military product B, or even dual-use product C?

What I am trying to get across is that this cannot be about a specific country. Ultimately, it needs to be about determining any potential foreign takeover or investment on the basis of whether it leads to undue or malicious interference and influence. In other words, if we are overly concerned with China per se, I believe that we run the risk of dumbing down our ability to determine where the real problems are, and are set to be in the future. We also need to recognise this as an opportunity to develop a system for proper and thorough evaluation and enforcement. If we do not, and we just sort of rear up over the Chinese, we will not see the next problems. Today's friends may not be tomorrow's friends, and, as we have said a few times in this session, even friendly countries may not have objectives that align perfectly with our own, even right now. That is why, again, this is not black or white; it is mostly grey.

Q310 Royston Smith: I knew that this was a complicated business. You have completely underlined that to me, in a way that—if I did not know it already—makes it more understandable than perhaps it was. I was going to ask you about how a country could be a risk or cease to be a risk, but you make it sound as though it is not actually about countries at all, and we probably should not be thinking about it in those terms.

Michael Formosa: No, I think that countries are a part of it, definitely, because they have strategic intent as well. They are just not the whole



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answer. I think they are an easy answer and a political answer for now, but we need a smarter determination.

Dr Lenihan: Can I hop in here to support what Michael is saying? If you look at the CFIUS case load from the last two decades, you will find that China is only a small proportion of the cases that are reviewed. It kind of depends on the year; more recently, it has been about a fifth. Often, because allied countries tend to be more comfortable making acquisitions in areas like aerospace, defence and telecoms, for example, you sometimes need to undertake a greater number of reviews that in that area.

I have a couple of quick points. I think the issue is that you need to understand the character and intent of the acquirer, and the character, intent and strategy of the country of domicile of that acquirer, or the country that influences that acquirer. On what Michael was saying about acquisition vehicles—holding companies and specialised acquisition vehicles—the number of cases reviewed for companies registered in the Cayman Islands or Nauru, or any other domain that does not ask too many questions of those who are setting up those vehicles, can be quite high in relative terms. You cannot simply have a list that says, “Okay, the company that is the acquirer comes from the UK so it’s fine.” We know, for example, that Gardner is now a UK-based company, but its ultimate ownership is Chinese, and that may be a bit of an issue.

In terms of countries of concern, it is definitely not just China. Historically, since about 1950, when some of these regimes were at their inception, and even since world war one, the countries of concern have changed dramatically about every decade. As Michael says, it is about China now, but it will not be in the future. It is also not just about China; it is about Russia, Venezuela and your allies that do not necessarily pay attention to export control laws. It is not always about malign intent or strategic intent; it is also about those countries that may be your really close allies and partners, but which are a little lax in their enforcement mechanisms, or which do not have the domestic laws needed to protect those companies once they are acquired and have potentially moved there. So, there are a lot of factors that need to be considered.

Michael Formosa: Ashley is exactly right. This isn’t about the countries per se; it is about their regulatory regimes and how they complement our own regimes and our objectives.

Another interesting example, from my point of view, is with the sopping up of large swathes of London real estate. The same thing is happening in a lot of major cities—it’s happening in New York; there was a piece in *The New York Times* not too long ago—where foreign buyers are coming in and buying whole purpose-built blocks of flats. The headlines are along the lines of “Russians buying up London,” but it should be more about whether or not money laundering is going on, and whether or not the country of origin is going to be supportive when it comes to that issue specifically



Dr Lenihan: Yes. There was the same issue with Japan and the US in the '80s. That was not about money laundering, but it raised concerns over a big influence of foreign investment. It raised other issues, which caused points of friction when it came to takeovers in the area of semiconductors, for example, that might not otherwise have had the same level of attention publicly.

It is really important to remember that the cases that often make their way into public debate are not necessarily the ones we should be most concerned about. If we look at the history of purchases by Huawei in the ICT and tech sector in the UK, I have rarely heard any of them mentioned in the UK press. They are very small stakes. They are seed money. They are acquisitions of incredibly small companies.

The big thing that the UK needs to think about, moving forward, not just in terms of China but in terms of other strategic competitors, is what constitutes, for example, an investment of concern that is non-controlling, and what constitutes an emerging or foundational technology that is going to be a security issue in the future, but is not necessarily one today. It all goes to support the things that Michael and I have been talking about throughout, which is that you really need redundancy in the process. You need multiple organisations, with multiple knowledge bases, who can raise flags and point out issues that might be missed by other teams.

Q311 **Chair:** I am going to jump in, very briefly. I refer you to my entry in the register of interests; I have some investments that may cover these areas. There are a number of start-ups in the UK—as we know, the UK is one of the major global hubs for start-up technology—that could easily become something pretty seminal in future computing, whether that is AI, quantum or any number of different areas. I am interested in the way you are talking about this. As you rightly say, this is not just about a hostile state or a potentially hostile state. It can be about the opportunity for the UK industry to grow, and it can be about other changes to the UK investment climate.

I would argue—I don't know whether you would agree—that two of the worst decisions that the UK Government have made in recent years are the permissions to sell DeepMind to Google and Arm to SoftBank. Neither of those are to hostile states; in fact, both are to extremely friendly states. The investment that Google and SoftBank respectively have made in those markets has, in many ways, been good for businesses, but the loss of control of the major chip manufacturer for mobile technology and the major AI company in the world really changes the UK's ability to influence the rules as those technologies go forward.

Would you see those two as examples, at least at a later stage, of the type of technology you are talking about? Do you see the danger that we could therefore end up having a large number of companies coming before this CFIUS-style regime, and churning up a lot of business for the civil servants who are looking into it? Dr Lenihan, perhaps you would answer.



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Dr Lenihan: I think that, going forward, it is important to be careful again not to move into areas that might historically be considered areas of protectionism. When it comes to DeepMind and Google, I understand the political debate around it, but again this is the kind of investment that, with a deep mitigation agreement, should be okay between allies. That is not just because you want to ensure that certain sectors are healthy and have a certain amount of competition in them going forward, to ensure innovation over time. And, you know, if that sale goes to an ally that shares your liberal economic values, all the better. In my mind, I don't see as much of a problem with that kind of sale.

The one with ARM and SoftBank is an interesting one, because just two years later ARM China was established as a joint venture through SoftBank and its ownership of ARM, and that joint venture is causing a lot of friction and issues currently, not just with the sale of ARM potentially to Nvidia but in general, with the dispute over control of chip manufacturing and refinement between the West and China at the moment. So, there might be some concern over that original sale that maybe there should have been some more stringent mitigation measures in place to ensure that certain forms of technology were able to be controlled going forward.

However, your other question was about going forward and kind of setting the rules of the road, I think, for new technologies. That should not be a matter of whether or not you have a particular company headquartered in your country. That is about voice and that is a place where again the FCDO can play a great role—

Q312 **Chair:** Is that not, Dr Lenihan, slightly hope over experience, in that if you have the corporates, who are writing the code, you have more say in how the code is written?

Dr Lenihan: How the code is written, but in terms of the regulations that surround that code going forward and the security mechanisms that are in place, for example, for telecoms and other forms of ICT, especially within the group of liberal economic countries that very long ago sat at Bretton Woods, I think that there is a large capacity for the voice of the UK going forward in that area. And that is the kind of thing that it should be actively involved in, because there is a lot of foundational and emerging technological innovation in the UK—you have got plenty of start-ups, you have got great researchers in this area, and it's not just about control over one company.

Chair: Okay. I take that point. Mr Formosa, you wanted to come in.

Michael Formosa: I also think that it is about having—we need a plan. We need to have an idea of what we want to protect and how we want to protect it, and to have an appropriate regulatory regime underneath that that is muscular enough to properly enforce it.

If you go back to the United States example and think in terms of export control laws and how they tie into the foreign direct investment, you have certain conditions under which the foreign investor needs to operate. That



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might be in a very sensitive area and it might be an allied country like Britain. For instance, BAE needs to operate with a proxy board, SSAs or other alternative arrangement.

In other words, let them come in. We are really good at innovation, but sometimes others are better at commercialisation, so leverage that fact, invite in the foreign direct investment, but provide guidelines that make sense and accord to an overarching plan for our development and prosperity.

Chair: Okay. That is a rather more reasonable way of putting it than I did. Thank you, I accept the correction.

Dr Lenihan: It is a really important point, the sophistication of the mitigation regime in the US. That is just a matter of longevity. They have been doing it for a very long time, so they have more alternatives at their disposal and they have used them more frequently. The special security arrangements that Michael mentioned are a great tool, especially when dealing with allies, and a very good way to go moving forward.

Q313 **Chair:** I am interested particularly in the way you put this, Mr Formosa—and I am grateful for your correction, as I said—because it raises the different ways in which the UK and the United States have approached, for example, Canyon Bridge and Imagination. It highlights a distinction—not a radical difference, but certainly a difference—that is worth looking at when considering, for which I am grateful.

Dr Lenihan: May I say one thing? It also raises another point, in that the Bill is sector-specific in its mandatory notification review regime, but one of the things that CFIUS piloted after FIRMMA was the idea of first using sector codes to determine what should be a mandatory notification. They are moving away from that and are now using, for example, the technologies outlined under ITAR and the different export control regimes as the basis for what becomes an investment that might fall under a mandatory notification system—rather than just a sector. If you look at their most recent report from 2019, you see that, somewhat unexpectedly, some of those technologies occur in a vast swathe of sectors, which I think even they did not expect. It seemed to be something that was more useful going forward in regulatory thinking. That might be something to consider.

Chair: Thank you. I agree. Thank you very much for all your contributions. That was extremely useful and raised many of the points that we were looking to be challenged, so I am extremely grateful. If we may, without any formal break, we will go straight to our next witness, Paddy McGuinness, and say thank you very much to Dr Lenihan and Mr Formosa.



Examination of witness

Witness: Paddy McGuinness.

Q314 **Chair:** Mr McGuinness, will you introduce yourself briefly for the record?

Paddy McGuinness: My name is Paddy McGuinness. I am a senior adviser at the critical issues firm, Brunswick Group. Formerly, when in Government service, I was the Deputy National Security Adviser for Intelligence, Security and Resilience in the Cabinet Office, where I oversaw the Investment Security Group.

Q315 **Chair:** You have long experience of operating a similar—not quite the same, but similar—style of unit in the Cabinet Office. What role do you see for the Foreign Office in this new structure? How would you look at it?

Paddy McGuinness: From that past experience, and when I look at what is now coming through this new legislation, I think that the Foreign Office has a vital role. Key to making use of all the capability of the British Government is the idea of lead Government Departments by sector—Departments that have statutory powers and staff who understand the sector—and it is vital that they play a role. Dr Lenihan referred to that.

The way I always thought of the Foreign Office was as the lead Government Department for foreigners. It was able, through its network and through the expertise and skills of its staff, to bring into the room much that was not available if one is sat in London—despite the internet, expertise and reading. The great value from the Foreign Office was its interaction overseas. That of course is about reflecting individual deals or investments that are under consideration. It is also about providing that context about intent. I think one of the things to reflect on—we heard it in the excellent session you just had—is that so much of what we talk about are lag indicators of what has happened to us. Now, I used to be a boxer, and I always preferred to spot when someone was about to hit me rather than when I had already been hit. One of the things the Foreign Office can do is understand intent and what is happening, as previous witnesses have described, not only in individual countries but in other places where their businesses are active, and it can reflect that back to develop the kind of strategy and plans that Mr Formosa was referring to in the last session.

Finally, it is very important to recognise that national security capability and the mindset is not a given. Government Departments play a large number of roles, and one of the difficulties I found in chairing the Investment Security Group was that many Government Departments do not invest in developed vetted staff, do not have the communications equipment or the physical space in which more sensitive material can be handled and do not have the disciplines that go around confidentiality or secrecy. Although the Foreign Office has slightly gone away from that in recent years, it still has that core capability, as do some other Departments—we have heard reference to the Ministry of Defence and the Home Office. But I think that understanding the importance of having national security capability to do national security and investment work is absolutely vital. BEIS is of course another Department that has had some



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of that capability—and, my word, it is going to have to build it up as we go forward with this new legislation.

Q316 **Chair:** So this requirement is going to make a big difference to the way many other Departments structure themselves and not just the Foreign Office. What should the Foreign Office be doing to enable them to ensure they have the correct structures in place? What skills does the Foreign Office in particular bring, without doubling up on all we have heard, on foreign reach and foreign understanding?

Paddy McGuinness: If I may, I will step back a bit and say two things overall about what we are dealing with here. First, as I think we heard from Dr Lenihan, it is not that somehow in the past this was done optimally in the United Kingdom or possibly in other jurisdictions. This is hard to do, and we are aiming to do something new and different. If we merely do what we have done to date, commit the same resource, rely on the same skills base and behave in the same ways, we will get the same results we have had previously—or possibly worse, given the volume of business now coming through because of changes in the world and changes in our understanding of this. So additional resource and capability is vital.

There is a risk, as we look towards the integrated review that is upon us, that there will be yet again an undue focus on what might be called hard defence military capability—I am strongly supportive of military capability—and that becomes something of a Maginot line in that, behind it, the necessary defences for our security in peacetime, or, one might say, non-declared conflict, are not invested in. I think above all else the key question is whether or not there is sufficient resource in all the Departments that feed into the new unit in BEIS, but in particular in the Foreign Office.

Having done it myself as a civil servant, I do not think it is enough to say at this point, “Ah, this is about getting Philip Barton”—the permanent secretary—“to make some choices. He’ll be able to sort this out.” No, that is not going to work. There is going to have to be substantial new resource, and there is going to have to be a process by which we build up the skills and the structures that are going to be able to support this unit. That is true in BEIS and that is true in the Foreign Office.

I think it is important that the Foreign Office has people in the unit in BEIS. Inevitably, when a Department is not sufficiently invested in, it draws in its staff. That was certainly my experience with some of the other joint units across Whitehall with the Foreign Office: when the Foreign Office came under resource pressure, inevitably it had to make choices and it chose to bring people home and try to make its contribution from within. It must have a strong presence in that BEIS unit and a strong interaction with that.

In terms of skills, it is important to recognise that this legislation is very welcome, but in many ways when I did some of this work in Government, what I was doing was in part dealing with the shortcomings of the



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Enterprise Act from a national security perspective. This legislation will strengthen that, and as we have heard, it may actually provide an enormous burden of work as well. It is important to recognise that a range of tools is available to Government with which to deal with national security concerns around private sector enterprises, and not all of them involve the use of statutory power. The Government buy things; they share information with companies that enables them to innovate; and often, there are right-thinking people on boards who lead companies and think of the right ways around this.

There are other interactions, and one of the interactions that is critical is real and detailed co-ordination with allies. Critical to my ability to do the job in the Cabinet Office when I was chairing the Information Security Group was the ability of, for instance, colleagues in Washington to have the right conversations with CFIUS and other colleagues, many of whom were constrained by legislation in what they could share formally, and had to think through how we could co-ordinate on areas that might be seen as areas of national competition.

When one thinks of the Foreign Office, it is important to think of them as being in a unique position to bring us what is happening in markets overseas and among enterprises overseas, and what intent there is that might have an effect on us. That is not about spying necessarily, or secrecy: it is about knowing where you are. The other thing is that they help us profoundly with co-ordination. Out of that, and out of the practice of individual cases—which I think is where we are going to learn here, rather than through a priori argument—will grow, and has grown, really significant expertise. I can think of individual Foreign Office colleagues who have a really profound knowledge of how one might approach this, either in co-ordination or in managing a host state, or a state they have previously been posted in. Those are the skills areas we need to be thinking about with the Foreign Office.

Q317 Chair: The skills and the structure you are talking about suggest, quite rightly, that this is a large, structured and formal organisation that has within it, as it were, the mandate to do this business. There is a danger that the Foreign Office can be too big within it and could exercise too much influence, is there not? Do you see that there is any role for the FCO in vetoing investments, or is that separate?

Paddy McGuinness: I do not think I was saying that there should be a particular structure in the Foreign Office, per se.

Chair: As an organisation, I mean. It is a structured organisation.

Paddy McGuinness: Yes, and joyously, it is able to meld together input from multiple different posts and multiple different perspectives, which is a really important input as we deal with this. I know there has been a whole discussion about how this should be structured and where it should sit. It became clear to me during my work as a civil servant that one wants, on the whole, the structures and bodies to be aligned with where the statutory powers are—so, the statutory powers are going to be with the



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Secretary of State for Business, Energy and Industrial Strategy. Having some arrangement where the structures are elsewhere does not really work.

There is a wonderful swinging pendulum between Administrations about how much is done centrally and co-ordinated in the Cabinet Office, or indeed in the NSC or inter-agency in the US, and how much is done departmentally. In a sense, there is not a right answer to that—it is about an Administration, or a Prime Minister and their Administration, choosing how it is going to drive the car, and there are various ways of doing it—but if we swing towards Departments, my strong view is that it needs to be aligned with where the statutory power lies.

Interestingly, however, if you accept that when dealing with these issues in Government, you are able to make use of the full range of powers that Government has, frankly, some of the “know your customer” regulation around finance and investment can have a deterrent effect against poorly constructed intelligence fronts. That is not an NS&I power; it is something that rests with other regulatory bodies—the FCA and others—but it has a useful effect.

One wants each Department that is involved in this process to be thinking about how they leverage their knowledge of the sector and their existing regulatory powers to have the national security effect that we are looking for. It is not going to be this single Act that is going to have that effect. It is going to put right a lot of things that were not present in the Enterprise Act or had been neglected and were not legally sustainable anymore, but it is not of itself going to solve all the problems. We are going to need the full panoply of what Government can do.

Q318 Graham Stringer: You indicated in your previous answers that we are going to get a more effective screening policy for foreign direct investment by experience—empirically, rather than a priori. Given that that is your view, what do you think the main obstacles to getting an effective screening strategy will be?

Paddy McGuinness: I would like to pick up and pull through into organisational design some of the things that were said in the previous panel by both Dr Lenihan and Mr Formosa, in particular about what I would call being barnacles on the boat. I think what is going to make it effective is if it has a narrow and specific national security focus. That does mean, in my view strongly, that it has to be able to address emerging technologies and foundational technologies—a phrase I think used by Dr Lenihan—and their significance for our future security. Look at where we are. We used to have defence that operated in three domains. We now have one that operates in five, so there are new technologies coming our way, but it needs to focus on national security.

Also, when one thinks about our throw weight as an actor in the world being related to our prosperity, that also helps markedly in not allowing this to become an obstacle to inward investment in the United Kingdom, to legitimate partnership, and to the kind of Chinese or Iranian—depending



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on the sanctions regime in place at the time, it does not fundamentally matter where—investment in the United Kingdom that is going to be well regulated and not lead to a national security risk. It is important that we do not have the barnacles on the boat.

I think that this Act or Bill is an opportunity to put that straight. Just at the moment, it is palpable that there is a confusion between public interest and national security—public interest being around jobs, prestige headquarters and other aspects, which are not the same as the management of defence-critical intellectual property, an underlying capability where we need a short supply chain, or the hollowing out of some part of, I know, the nuclear endeavour, which is critical to our resilience.

Q319 Graham Stringer: Can I leap on to a consequent subject? Assuming that we have an effective screening programme and we stop some foreign direct investment, there are likely to be diplomatic consequences from that. We have already seen that from China incipiently. How do you think the Foreign Office should react to mitigate that?

Paddy McGuinness: If there is clarity about why something is required, that can be expressed privately by diplomats—by our excellent ambassador in Beijing and her staff. That, in a way, makes it more manageable. I think there is the risk of having a diffuse, friction-full, slow and—dare I say it—clumsy set of referrals and processing of those referrals in the new unit. If we allow that to happen, if we are not good at saying, “That does require review; that does not,” and quickly getting through that, and if there are long delays in the processing of it, there is going to be general irritation, I think, on the part of foreign Governments.

Where one is able to go in and say, “I’m sorry, but it has been determined that this particular thing is absolutely critical to a part of our national defence and you wouldn’t dream of letting us invest in it in your country,” that is a much more straightforward message for our diplomats to carry, frankly.

There is a useful alignment between what is needed for business, which is predictability, clarity and speed—that is intended in this Bill; let’s see if it gets into the Act—that helps us with our diplomacy too, because it strips away and we get down to the fundamentals. Having had to deal with these kinds of issues—I won’t say which ones—with American colleagues saying that things had to be a particular way and, “I’m sorry, that was just the will of the United States of America”, when one has that kind of clarity, it is easier to communicate and it reduces the general difficulty around it.

I know you, as a Committee, will be aware of the noise and the lack of clarity around our vital economic partnership with China and several other states, which is pernicious. A good degree of clarity about what matters and what doesn’t is of much greater use to business and to our diplomats.

Q320 Graham Stringer: I am sure you are absolutely right about speed. In terms of clarity, do you think it is possible in policy and in principle to



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state, "This is the kind of inward investment we will not have," so those countries would be under no illusion that there would be difficulties if they wanted to purchase or invest in this area? We are using China as an example, but there would be other countries that it would apply to, including friendly, allied countries.

Paddy McGuinness: I am worried about that. I am worried about hard lines being drawn, which then become overly rigid and result in us either not getting the right kind of economic investment, which is sometimes necessary for restructuring in particular sectors, or not drawing the line clearly enough. I firmly believe in a case-by-case approach to this.

From my perspective, we have learned recently that the use of the term "trusted supplier" in the technology space is not that helpful if suppliers from allied states are being undermined by, dare I say it, organs of the Russian state. If we choose our technology supplier on the basis of flag, we will not necessarily end up with a well-run, resilient network.

The same is true of investment. Personally, I am not much in favour of whitelisting. Rather, I think you are able to communicate that you are likely to view an investment from a legitimate body in the United States, Australia, Canada and so on, much more favourably than one might from elsewhere. You can indicate that, but I don't think you can give an absolute assurance either that you would accept it on the basis of, "Oh, it's a trusted investment because it comes from..." or, "Oh no, we can't accept that because it is from this state that we have a difficulty with." I just don't think you can do it, except on a case-by-case basis.

Graham Stringer: That is very interesting. Thank you very much.

Q321 **Chair:** Before we go on, I am interested in your SolarWinds parallel. Would it be fair to say that is what you are referring to?

Paddy McGuinness: I have dealt with, in recent years—let me just check they are all public; yes, they are. I used to chair the Telecoms Industry Security Advisory Council, which I think is now subsumed into DCMS, which meant I got to see all the CEOs of the major technology background providers. We had to deal with multiple instances where technologies were being bent out of shape, not by Chinese actors, but by Russian actors. I am thinking about SS7 and about the announcement in 2016 or early 2017 by the National Cyber Security Centre, alongside the FBI, of a compromise of half a million routers around the world, all of which came from Europe, the United States and other trusted suppliers, but had been subverted.

I have come away today with some really useful ideas and words, and I think the word "redundancy" is the most important for me. We need an approach where we look at things in multiple ways. We have—and this is something about which I got into a discussion with someone involved in doing—*[Inaudible.]*

Chair: Forgive me, you have frozen. We appear to have lost Mr McGuinness. Can we try to get him back? I think we are struggling to get



him back—let's see if he rejoins. Forgive us just for a moment as we try to get him back. I think those who are watching or who will read this later will see why I am very keen to get Mr McGuinness back on. His wide experience as deputy national security advisor and of working at the heart of Government and advising on these different challenges that we now face is extremely useful for us in terms of this law. Given what we have heard about the challenges of applying this law fairly and about what whitelisting could do to undermine as well as protect us, this is one of the most important and challenging elements. Given what Dr Lenihan said at the beginning of the first sessions, I think we are all also very conscious of the danger of overloading an embryonic structure so that it is unable to conduct its functions appropriately. Let us just hold there as we wait for Paddy McGuinness to return.

Paddy McGuinness: There we are—I have returned. I apologise.

Chair: Excellent—thank you very much, Mr McGuinness. You froze on us and we can only assume that that was not a hostile act. Luckily you had resilience, so we are back.

Paddy McGuinness: Where did I vanish?

Chair: You vanished at the beginning of talking about resilience and how the thing that really struck you was the need to have resilience.

Paddy McGuinness: Yes, I think you were asking about my SolarWinds parallel, as you put it. That was your term, not mine—I did not say SolarWinds. I think I was saying that I dealt with multiple examples where infrastructure had been interfered with, and the origin of the infrastructure was not a good indication of whether it was safe from interference. We need a diversity of ways and redundancy in how we understand what is happening with inward investment. That might be about small investments in particular technologies, or it might be about very large ones. That clearly is about understanding the intent of those who invest in the United Kingdom. The commercial intent—I can think of examples—can sometimes be to neutralise, frankly, the potential of a technology that is emerging in the United Kingdom. If that has national security relevance, we need to deal with in using these powers.

Chair: Fantastic. Royston, you wanted to come in.

Q322 **Royston Smith:** I just want to take you back a bit, Mr McGuinness, if I can. You talked about the public's priorities. Let us assume that the public's priorities are the FCDO's priorities and the Government's priorities—the Chairman is laughing because I am saying "assume"—there is something of a conflict between security and prosperity. How will the FCDO manage to balance those priorities? How should it?

Paddy McGuinness: The answer is that it must escalate and share them, because ultimately, the FCDO cannot be the decision maker on our industrial strategy or economic positioning in the world. I think we all recognise that out of our prosperity comes our global throw weight, so we have a fundamental national security interest in being prosperous. It is



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also quite nice as a citizen to live in a prosperous country—I'd know. So I think escalation is a critical one.

We have, and we need to continue to invest in, a very strong diplomatic network, and diplomats of great capability; and a particular thing they do is they negotiate, and they deal with difficult people. They are good at judging where the real red lines are in foreign capitals—getting behind the theatre and really understand what matters to somebody with whom we are in competition, or perhaps even is an adversary. In my experience that advice, sat at the advisory end of the National Security Council table or in other meetings, is of enormous value, because one understands where the risks really are, rather than megaphone diplomacy back and forth, which is not useful.

I think one of the ways of thinking about this is that the value in that is that you deploy your diplomats; they have the conversations, they have that—*[Inaudible.]*—share it with you in private advice and—*[Inaudible.]* But also you make sure they have some room for manoeuvre. If it is felt by a state—particularly one that is given to bullying, and many are—that the person in front of them can be pressured into changing a decision because it is in their hands, whether that be around investment, I don't know; an immigration decision; some other decision that has been taken; a decision to close airports because of a threat to aviation would be an example, to my mind, at the moment: you actually make it more difficult for them to do their job. So there is something really important about the organisational design, here—about how you define what the role of the Foreign Office and your diplomats is, and how you give them room to contribute. I think that's where they help with this balancing off—not in making the decisions themselves, because they can't.

Q323 Royston Smith: What about between Government Departments and Government policy? Security implications of foreign investment being weighed against other Government policy: that wouldn't be diplomats, would it? Is the FCDO well placed to be doing that, working across Department?

Paddy McGuinness: Getting Departments to work together in any Government structure, in any capital—even ones that are very small—is difficult, and it requires constant work and constant thought. In my experience, the Foreign Office, both because of its centrality to our national security work but also because of the quality of its people and the way in which it exports them—one thinks of it at the moment; one thinks about what one will find in other Departments, and in particularly the Cabinet Office and No. 10—one will find people who have come from the Foreign Office and are likely to return there and have connectivity. That great British thing, which is much more straightforward in the UK than it is in the United States, with its proportionately so much larger Administration—that is a great strength, the habit of working up and down within your Department and across; but it needs to be constantly looked after.



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One of the things that I am not clear about yet, and I think probably will come out in practice, but needs some thought, is what the escalation route is. I think the legislation, as it has been proposed, is very clear about who is responsible for what, and where the statutory powers lie; but if there are differences of views between Departments—I know there is a proposal for a group led by the Chancellor of the Exchequer, which is great; that is super; that is very good in terms of investment strategy—but if we reach the point where there are these really hard decisions to take, there needs to be an escalation route to the National Security Council and we will need to keep an eye on that. I know that colleagues in the Foreign Office will want that. They will want an escalation route that is clear, because there is nothing worse than something running into an uncertain process. I am probably repeating something that Dr Lenihan said in the last session—or maybe it was Mr Formosa—about just clarity in process.

Royston Smith: Thank you. Thank you, Chairman.

Chair: Graham, do you want to come back in?

Graham Stringer: No, thanks, Chair. I asked a question on the issue I wanted to.

Q324 **Chair:** In that case, I will close with a last couple of questions, if I may, Mr McGuinness. Universities and other academic institutions have been very prominent in recent days—I'm sure you've been following the news as much as the rest of us—and you will have seen that links to foreign-owned companies have often raised concern, not always directly because they are actual branches of the People's Liberation Army, for example, but sometimes because they are connected to businesses that may have other interests as well. How much should these university connections be considered when considering national security of foreign investment?

Paddy McGuinness: I think that universities and academic bodies need help and support, and they also need clarity on points of contact and how to assess—sorry, I am going around this because I think this is a huge question.

First of all, my word, what a fantastic asset in terms of soft power our universities are, and the education that they offer! Indeed, the joint research that is done across the world when you think of what we are dealing with in response to this pandemic, and the way in which it's been a mixture of nationalities and institutions working together on what is being achieved in the world. It isn't being done in one lab, in one place, by one person, and everyone acknowledges that. One has that sense in one's mind that this needs to be protected and cared for, and we don't want barnacles on that boat, particularly.

I have anecdotal experience from being involved in a few cases where universities, faculties or colleges have had to deal with this. I'm speaking to you from just outside Oxford, as it happens, and I do some work with companies in which Oxford University is invested. Oxford University has a really quite solid way of clearing what is done, and, indeed, getting advice



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from the Government and other bodies so that it can make a judgment about where it should be concerned, and where not. But I have been consulted, on a pro bono basis on occasions, by colleges and faculty members who have been puzzling through how they should deal with something; didn't know where to go; didn't know where to get the right advice, and so couldn't gauge it. They were therefore arguably displaying an abundance of caution, to the point where they actually might have been disadvantaging themselves, saying, "This is a bit tricky, and should we accept this investment from country X, this partnership? Should we train some other people in this subject? Does it have a defence application? Should we be concerned?" They wanted a bit of clarity.

Again, this is one where redundancy is required. There are a number of ways in which the Government talk to universities. I do think that the Department for Education, BEIS, and indeed the Foreign Office, have a responsibility for thinking how to support these institutions to make the right decisions. To borrow Dr Lenihan's term, redundancy is really important here.

One of the things we haven't really talked about in this session—I'll bring it out now and it applies across the piece—is the problem of dealing with a lag indicator. The biggest problem I think I have faced, both when working in Government on these issues and since Government, working with businesses who wanted to do the right thing and steer their way through this, has been how late Government perceives what is happening and forms a collective view. That means everything is being done at pace, there are commercial pressures, sometimes deals have already been done.

The new legislation on investment seeks to address that, but that is equally true when one thinks about the support required for higher education research bodies. They need a nice, steady, straightforward, clear way in which they can get advice, and they need to be wrapped around. Usually at post in an embassy or a high commission there will be a sense of what is happening in some of the higher education partnership with that country, but it won't be complete, and we shouldn't expect it to be. It is part of a composite picture that needs to be put together, and I think there is room for greater clarity for universities, colleges and faculties to know where they can go, formally or informally, to get advice. There is great variation in how they do it, how well they do it and how good the advice they get is.

Chair: Thank you very much indeed. I am extremely grateful for your time this afternoon, Mr McGuinness, and thank you as well to Dr Lenihan and Mr Formosa for very kindly staying on to listen to the rest of this evidence. I have to say, I've got a lot out of this; not least the complexity with which we are dealing and the need for redundancy, not only within the structure of the new organisation that is being set up to, in some ways, replace the organisation that you led, Mr McGuinness, but also the need for resilience and, I would say, imagination within the Foreign Office in how they hire and structure their own people who are going to support it. This is going to be very far from black and white and will demand huge



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amounts of reach back to posts around the world, as well as to get experience from former posts that people filling these jobs will now have. On that, and on the need for judgment, I am extremely grateful for all of your insights.