

THE EUROPEAN UNION ADVANCES ITS ECONOMIC SECURITY STRATEGY: FOCUS ON FOREIGN INVESTMENT SCREENING

THE EUROPEAN ECONOMIC SECURITY STRATEGY

In recent years, rising geopolitical tensions have raised the risk profile of economic security for Europe. In response, a Joint Communication on a European Economic Security Strategy (the "**Strategy**") was adopted by the European Commission and the High Representative for Foreign and Security Policy in June 2023.

Today, the European Union ("**EU**") writes a new chapter of this Strategy, with the publication of a set of five new initiatives: the harmonisation of foreign direct investment ("**FDI**") regimes; increased coordination of export controls of dual-use technologies; further control of outbound investment; the promotion of research and development on dual-use technologies; and proposals to enhance research security. In addition, the European Commission is currently assessing the need for tools to control outbound investment in key technologies such as advanced semiconductor technologies, artificial intelligence technologies, quantum technologies and biotechnologies. We focus below on the measure proposed to harmonise FDI regimes.

On 24 January 2024, the Commission unveiled a proposal for a Regulation on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 (the "**Proposal**"). The Proposal mandates Member States to set up and maintain a mechanism to screen certain foreign investment on the basis of specified criteria. The primary objective is to enhance legal certainty by ensuring consistency between national screening mechanisms and to foster more effective cooperation between Member States and the European Commission.

With the Proposal, the European Commission seeks to address issues identified in the existing Regulation 2019/452 (the "**2019 FDI Regulation**"), which was adopted on 19 March 2019. Reviews of the 2019 Regulation revealed the adverse impact of the regulatory fragmentation resulting from divergent national regimes, leading to compliance costs for investors and hindering investment in the European economy. Consequently, the Proposal provides for minimum harmonisation of the essential features of foreign investment screening, including (i) defining the scope of covered investments, (ii) establishing the principal procedural features of the screening mechanism, and (iii) setting out a framework for effective cooperation between the Member States and the EU.

SCOPE OF THE PROPOSAL

The European Commission's proposed screening mechanism marks a departure from the approach to what constitutes foreign investment. Notably, it broadens the scope of review to encompass both direct investments in the EU by non-EU investors and indirect investments within the EU by EU entities controlled by non-EU investors. In

other words, both direct and indirect foreign investment are covered, as is already the case in certain Member States.

Under the Proposal, foreign investment encompasses a broad range of investments that establish or maintain lasting and direct links between investors from non-EU countries and undertakings conducting economic activities in a Member State. This means that the Proposal also applies to investments in EU targets, where the EU target is a subsidiary of the foreign target in which the investment is made.

Nonetheless, the Proposal is consistent with the 2019 FDI Regulation with respect to portfolio investments, which remain outside its scope, provided they are purely for financial investment without any intention to influence the management or control of the target. Similarly, the proposal clarifies that restructuring operations within a group do not constitute a foreign investment, provided there is no change in the effective participation of one or more foreign investors in the management or control of the target.

MANDATORY SCREENING MECHANISM

Another key difference with the 2019 FDI Regulation is the shift from a voluntary to a mandatory approach, compelling Member States to set up and maintain screening mechanisms for foreign investment. While Member States retain sole responsibility for national security, the proposal mandates a compulsory screening mechanism for investments impacting EU security or public order interests.

The Proposal outlines a two-tier approach to mandatory screening and notification of specific foreign investments:

- **Projects or programmes of EU interest:** Member States must screen and notify foreign investments in projects or programmes of EU interest listed in Annex I. These are projects or programmes covered by EU law which provide for the development, maintenance or acquisition of critical infrastructure, critical technologies or critical inputs which are essential for security or public order. Examples include the Euratom Research and Training Programme, the Trans-European Networks for Transport, and the European Defence Fund.
- **Areas of particular importance:** Member States must screen any investment in an area of particular importance for the security or public order interests of the EU listed in Annex II. The areas listed include dual-use items, military equipment, critical technologies (e.g., semi-conductors and artificial intelligence) as well as entities and activities which are critical to the EU's financial system.

In the second scenario, the foreign investment must also be notified to the cooperation mechanism if one of the pre-defined risk-based conditions are met. In particular, the Proposal outlines two high-risk situations that require notification of the investment: first, when the foreign investor or its EU subsidiary is under the direct or indirect control

of a third-country government, and second, when the foreign investor or any associated entity or individual is subjected to EU sanctions.

SCREENING CRITERIA

The Proposal maintains the concept of "likely to negatively affect security or public order" of the 2019 FDI Regulation, but now offers some additional clarifications and specifications with regards to the criteria that must be taken into account. Under the Proposal, the Member States or the European Commission must in particular consider whether the investment is likely to negatively affect:

- the security, integrity and functioning of critical infrastructure, whether physical or virtual;
- the availability of critical technologies;
- the continuity of supply of critical inputs;
- the protection of sensitive information, including personal data, or
- the freedom and pluralism of the media, including online platforms that can be used for large scale disinformation or criminal activities.

Moreover, the Member States and European Commission must consider various factors related to the investor or related entities (i.e., any entity or person controlling the investor, the beneficial owner of the investor, subsidiaries of the investor and any other entity or person controlled by the investor), including: previous transaction approval history, sanctions status, previous involvement in activities negatively affecting security or public order, engagement in criminal or illegal activities, and alignment with third-country policy objectives or military capabilities.

THE COOPERATION MECHANISM

The Proposal provides for an enhanced cooperation mechanism, requiring Member States to notify certain investments, as outlined above:

- any investment subject to in-depth investigation under their national procedure and any investment prohibited or subject to mitigating measures without an in-depth investigation must be notified within 30 calendar days.
- any investment relating to areas of particular importance where the investor is controlled by a third-country government or subject to sanctions must be notified within 15 calendar days.

Member States have the option to notify investments considered to be of potential interest to other Member States or the European Commission within 15 calendar days. Notification under the cooperation mechanism is done using a standardised form in accordance with an implementing regulation of the European Commission.

Member States can provide comments through a secure system if they believe an investment may affect their security or public order, or they possess relevant information. Similarly, the European Commission can issue a motivated opinion in instances where there is a potential negative impact on the security or public order of multiple Member States or Union interest projects, or if it has relevant information. The European Commission may issue an opinion addressed to all Member States where it considers that several foreign investments, if taken together, could negatively impact security and public order in the EU.

The Proposal establishes a framework for discussion between the Member States and the European Commission in relation to notified investments:

- following the receipt of a comment or opinion, the relevant Member State must set up a meeting to discuss how to best address the risks identified;
- the relevant Member State must notify screening decisions to the commenting Member States and the European Commission no later than 3 calendar days after its notification to the parties to the transaction; and
- the relevant Member State must provide written explanations of its decision, the extent to which the input of other Member States and of the European Commission was taken into account and the reason for disagreement, no later than 7 calendar days from notification.

For multi-country transactions requiring screening by several Member States, the Proposal provides for a dedicated procedure with aligned deadlines and coordination by Member States on the final decision. Applicants must file a request for authorisation in all relevant Member States on the same day, referencing each other. The relevant Member States must then coordinate the notification of the transaction under the cooperation mechanism on the same day (for investments subject to in-depth investigation) or within 15 calendar days (for investments relating to areas of particular importance where the investor is controlled by a third-country government or subject to sanctions).

KEY FEATURES OF THE PROPOSAL

Some of the essential features of the Proposal include:

- **Authorisation Requirement:** Relevant investments are subject an authorisation requirement prior to completion and a two-stage review process at Member State level (initial review followed by in-depth analysis where required).
- **Own-Initiative Reviews:** Other investments are susceptible of own-initiative review by Member States or the European Commission for at least 15 months following completion if it is considered that they may affect security or public order. The European Commission and Member States may also introduce own-initiative procedures with respect to investments occurring in the territory of another Member State if it has not been notified under the cooperation mechanism.

- **Compliance with Cooperation Mechanism:** Member States' screening mechanisms must be compliant with the cooperation mechanism. Amongst other, this requires the designation of a national contact point, ensuring national laws allow for compliance with the regulation, e.g. by granting the relevant screening authority the necessary investigatory powers, and the allocation of sufficient resources for effective participation in the exchanges with the other Member States and the European Commission.
- **Decision on Negative Effects:** Where potential negative effects of an investment on security or public order are identified, Member States must issue a decision prohibiting the investment or authorising it subject to mitigating measures.
- **Secure Database:** The European Commission will establish a secure database accessible to all Member States, containing details on foreign investments evaluated through the cooperation mechanism and the results of assessments conducted by national screening mechanisms.
- **Consistency with EU Law:** The FDI regime is interpreted consistently with other sources of EU law, such as the principles of freedom of establishment and free movement of capital and the EU Merger Regulation. Indeed, if other measures of EU law were to address an investment's effect on security and public order, Member States must approve the investment without conditions.

The proposed regulation would start applying 15 months after its entry into force. By then, all Member States must have taken the relevant legislative action and/or implemented the required procedures.

INTERACTION WITH UNION POLICIES

The Proposal seeks to strike the correct balance between two core objectives of the Strategy: on the one hand, promoting investment into the internal market and, on the other, protecting EU economic security. Although it broadens the scope of FDI review, the proposal should contribute to increased legal certainty and reduced compliance costs. Nonetheless, certain key concerns remain unaddressed. For instance, the Proposal falls short of a full harmonisation of the time-frame of the two-stage assessment of FDI by Member States, despite the fact that the divergence in procedural timelines has been flagged as a key issue by stakeholders.

More generally speaking, this proposal will raise questions regarding the coherence with the EU industrial policy and other EU instruments. The Commission is adding tools to the EU's legislative arsenal with the aim of fostering innovation and fortifying the resilience of value chains in strategic industries, as well as to react to practices which, in some shape or form, leverage economic dependencies. Among these, the Foreign Subsidies Regulation holds a particular place as does the Anti-Coercion Instrument, which entered into effect on 27 December 2023. Alongside these, traditional tools like trade defence instruments and export control rules on dual-use items, are also gaining prominence as instruments the EU can deploy in an increasingly tense global economy.

Effectively employed, these instruments can address legitimate concerns about leveraging dependencies in strategic industries. However, it remains to be seen how this legislative arsenal, in particular in cases of overlap and interaction between different instruments, will impact the attraction of investment in the EU, which is crucial for developing industries identified as strategic in EU policies adopted over the course of the present mandate. The Council and the European Parliament's responsiveness to these concerns will determine whether the new FDI Regulation can strike an effective balance between economic security and the objective of promoting investments in the internal market.

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