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"Reverse FDI"

Towards an EU Outbound Investment Control Regime?

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Over the last couple of years, the European landscape in terms of investment control regimes has changed radically, with 19 member states now having foreign direct investment (FDI) regimes.

Those regimes are directed at screening inbound investment in companies located in a specific jurisdiction by buyers that are directly or indirectly owned by companies, individuals or governments outside of that jurisdiction. Consequently, those laws do not apply in a situation where an EU company actively makes investments in countries outside of the EU, e.g. puts their R&D or production in a country with national security concerns. Outbound investment control[1] has recently seen much discussion on an EU level. A similar discussion is taking place in the US.

A big risk involved in an outbound investment control regime is that it can more easily be used as a means for industrial policy. In an FDI context there is always the need to strike a balance between national security concerns on the one hand, and the economic advantages of foreign investments from abroad, which is typically economically advantageous for the receiving State, on the other. In an outbound investment context, from a state's perspective, blocking an investment will, more often than not, be a win-win situation – national security is safeguarded while at the same time the unwelcome delocalisation (of funds, knowledge or jobs) is blocked.

What Is Outbound Investment?

FDI can be categorised as internal or outbound FDI. Internal FDI is where a non-resident invests into a resident company, whereas outbound investment occurs when a resident invests in a non-resident company. Typically, screening regimes in the EU and US have focused solely on internal FDI, but with outbound investment getting more traction they can be expected to be screened similarly soon.

Are There Already Outbound Investment Control Regimes in Force?

Yes. Interestingly, China is one of the major countries with a mature regime systematically screening outbound investment for, *inter alia*, national security risks. Generally, outbound investment must be registered with both the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), as well as being registered with a state-approved foreign exchange bank. Whether a specific outbound investment is additionally subject to approval from the NDRC, or similarly the MOFCOM, depends, *inter alia*, on the sensitivity of the project, the classification as a direct or indirect investment2 and the investment volume.

However, arguably, this is not an outbound investment control regime of the type the European Commission has in mind. The Chinese law also addresses investments in areas that are not sensitive from a national security perspective, i.e. in the hotel, real estate, film and sport sectors, whereas the commission intends to address those that are exclusively of interest to national security. As such, the main goal of the Chinese regime seems to be currency regulation, which may be adversely affected due to the capital and currency outflows that accompany the increasing amount of outbound investment.

Systems that resemble more closely what the EU has in mind can be found elsewhere:

South Korea – Outbound investments by companies that develop critical technology, developed by their government subsidies, are restricted.

Japan – Outbound investments in specified and limited sectors, such as weapons, are subject to approval.

Taiwan – Outbound investments below US$50 million are required to be filed; above that threshold, such transactions undergo case reviews. Outbound investments into China are additionally regulated depending on the industry, with a general prohibition on high-tech industries.

1 Outbound investment is often referred to as "outbound direct investment" or "ODI" – in reference to FDI – even though it is, strictly speaking, a misnomer, as indirect investments would also likely be covered.

2 Where NDRC is concerned, sensitive outbound investment is always subject to approval, regardless of its being direct or indirect. Non-sensitive direct outbound investments only require registration, and non-sensitive indirect outbound investments only require the submission of a project investment report, and only if above US$300 million.

Where Do We Stand?

The commission has previously announced its intentions to develop a restrictive outbound investment control regime by the end of 2023. In the context of its strategy for developing a framework for the management and assessment of security risks raised by certain economic activities, the commission has committed to strengthening the current FDI regulation by including outbound investment control.

The regime is expected to target specified sectors related to critical technology, i.e. military and intelligence capabilities, with the capacity to undermine national security. Examples such as quantum computing, artificial intelligence, 6G, biotechnology and robotics have been referenced. However, questions remain open as not much is currently known about the regime:

- Will outbound investment control mirror the current EU (internal) FDI regime where member states have retained their jurisdiction, or will the commission establish its own enforcement authority?
- Will the outbound investment control regime be narrow or wide in its remit, focusing on specific countries and types of investments?
- How far an impact will the outbound investment control regime have on countries such as the UK?
- Will EU and national lawmakers manage to align their outbound investment control regime?

Currently, no member state has an outbound investment screening tool, but they could easily adopt their own as investments policy, unlike trade policy, which is still managed at a national level. This may risk a non-holistic approach on an EU level. A current example is Germany, where an outbound investment screening tool is being contemplated as part of a new China strategy. The strategy paper suggests outbound investment control as a measure of risk mitigation to safeguard state-of-the-art technologies and R&D from being used to advance military capabilities to the detriment of international peace and security. Nonetheless, reference is made to the necessity of strategic partnerships on an EU and international level, with a suggestion to align action (i.e. any new outbound investment control regime) with the EU and other strategic partners for the greatest possible effectiveness.

As mentioned earlier, there are similar considerations in the US with different proposals, including outbound investment notification and review mechanisms. The latter has been described as the "reverse CFIUS" – referring to the Committee on Foreign Investment in the United States (CFIUS) – as it involves the creation of a new committee to review certain outbound investments related to countries of concern and in sensitive technologies or industries, such as semiconductors and AI. Such investments are classified as potentially having national security implications, as they could threaten US security by advancing progress in other countries considered as national security threats.[3] Legislation for outbound investment screening in the US is presently being considered in Congress, with some form of screening regime being expected this year.

3 This approach is not without its critics. Concerns include:

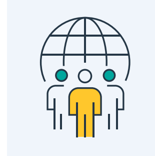
- US investors being at a disadvantage compared to other international investors without similar restrictions.
- The regime extending far beyond national security concerns and capturing purely economic transactions.
- The definition of investment, specifically whether it covers passive investments, such as "know-how". However, government rhetoric negates this, saying the regime will focus on active investments, such as acquisitions and joint ventures.
- The added compliance burden this would place on the investors.

What Can Be Expected?

Both the EU and the US have identified that domestic companies engaging in outbound investment pose a risk to national security through the loss of technology, adversely improving certain other countries' security, and creating entrenched geopolitical relationships. That said, the development of outbound investment control regimes will need to strike the balance between protecting national security interest with avoiding encroaching on a policy of economic protectionism. Although outbound investment control regimes are currently in their infancy, it appears that these regimes will quickly develop. As set out above, blocking an outbound investment is an attractive option, not only from a national security perspective, but also from an industrial policy perspective, as it keeps money and jobs at home.

The scope of such laws would have to be carefully determined, especially as, arguably, there is less protection from the judiciary – the European Court of Justice (ECJ), in the recent Xella judgment (C-106/22 of 13 July 2023), put a limit to the member state's scope of application of FDI regimes in a case where Hungary blocked the acquisition, by an Irish-owned Bermuda entity, of a gravel producer arguing the continued supply of gravel is a national security concern. It is questionable whether investments outside of the EU would fall within the remit of the ECJ's jurisdiction.

Our Firm at a Glance



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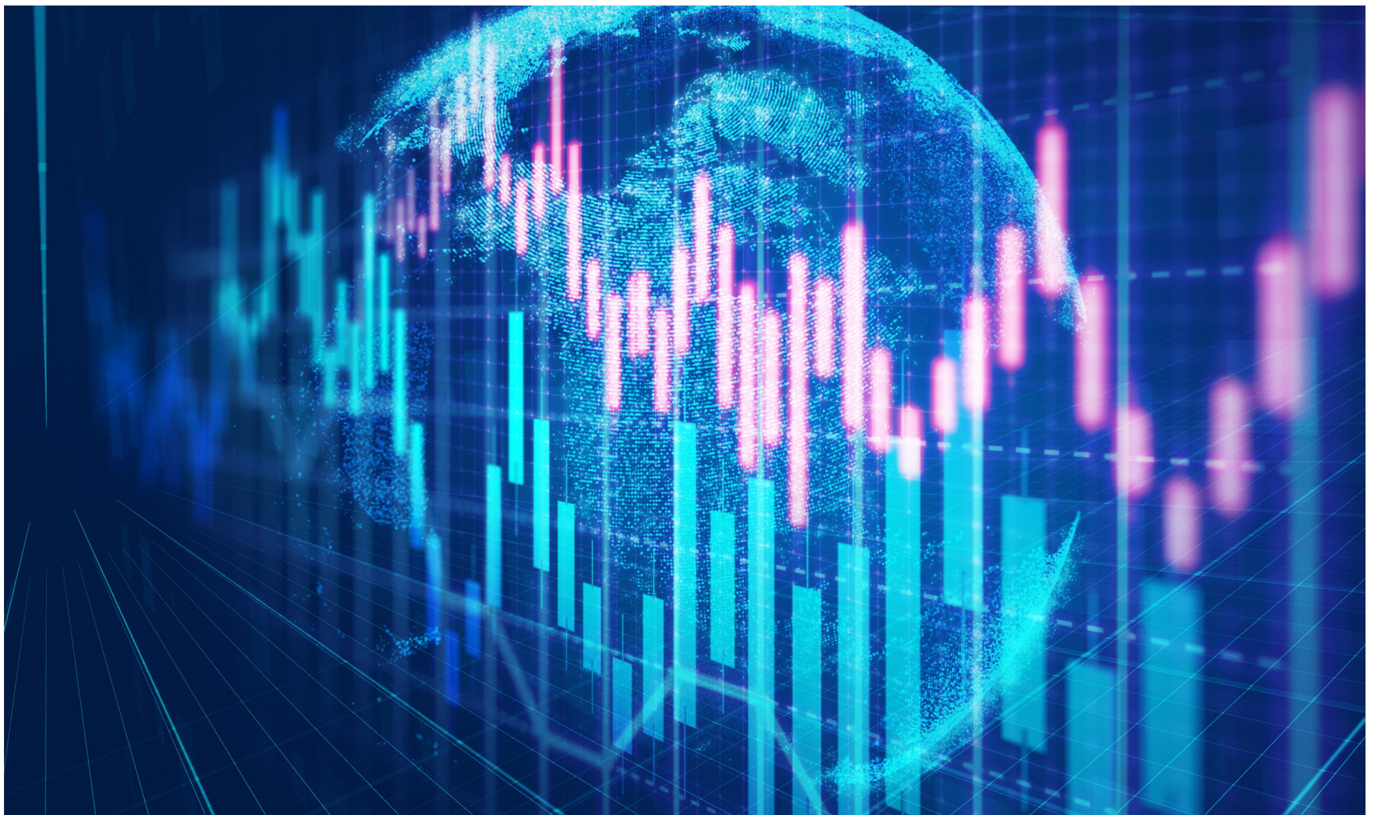

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