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Unveiling the New EU Foreign Investment Regime

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To address growing geopolitical tensions and technological shifts, the European Commission presented, on 24 January 2024, five new initiatives for strengthening the EU's economic security.

Part of the package is a proposal for a new regulation on the screening of foreign investments, whose aim is to update Regulation 2019/452 (FDI Regulation), which is currently in force. As explained by the European Commission, "the proposed changes reflect new geopolitical and security challenges" and "address the gaps and shortcomings" of the existing system.

Background

The FDI Regulation, which has been in operation since October 2020, established a framework for EU member states to screen certain foreign direct investments (FDI) in their territory to safeguard national security or public order. At EU level, the framework is mainly aimed at establishing cooperation between member states, while the screening itself takes place at national level. Since October 2020, the European Commission and member states have reviewed more than 1,000 FDI transactions. However, based on experience with the current framework, as well as the results of a public consultation launched in June 2023, the European Commission decided it was time for a revision. The proposal purports to close identified loopholes, including fragmented national regimes and insufficient cooperation between national screening authorities, but remains far short of what businesses would like to see: some level of harmonisation on trigger points, processes and information required.

Mandatory Approach for EU Member States

The current FDI Regulation gives member states the freedom – but does not impose an obligation – to screen FDI in their territory. This would change under the new regime, as the proposal introduces an obligation for all member states to adopt a foreign investment screening mechanism. 22 member states already have such mechanisms in place, meaning that the new requirements will only have an impact on Bulgaria, Croatia, Cyprus, Greece and Ireland, although the Irish screening regime is expected to come into force in the next few months.

Widening the Scope

The proposal broadens the interpretation of what constitutes "foreign investment". Unlike the approach under the current FDI Regulation, the new regime will cover both direct and indirect foreign investments. The test is whether the investment "establishes or maintains lasting and direct links" between foreign investors and entities active in the EU. From a practical perspective, this means that foreign investment screening will apply not only to direct foreign investments in EU entities, but also to (i) investments in EU targets by EU entities controlled by foreign investors, as well as to (ii) investments by foreign investors in non-EU targets with EU subsidiaries. This approach is already the case in some member states but was not captured by the FDI Regulation (except in exceptional circumstances). Greenfield investments will also be within scope of the new regime, meaning that a foreign investor establishing new facilities in the EU will be subject to foreign investment screening.

For businesses, this will not mean a noticeable change – the national laws already cover indirect investments, and, in many cases, the EU cooperation mechanism runs in the background.

The proposal retains exceptions from the current FDI Regulation – purely financial investments and intragroup restructuring operations (which do not affect the influence of the foreign investor) will remain out of scope. However, as before, member states will remain free to widen the scope and introduce stricter rules at national level, as is already the case with some member states capturing intragroup transactions.

Two-tier Screening

Greater convergence between member states' foreign investment regimes when it comes to the main features of the procedure is a key aim of the proposal. Under the new regime, the minimum must-review sectors will be harmonised, as it outlines two categories of investments that will be subject to a mandatory screening and a stand-still obligation:

- The first are investments in certain projects or programmes covered by EU law, as listed in Annex I (e.g. Trans-European Networks for Transport, Trans-European Networks for Energy, Trans-European Networks for Telecommunications, European Defence Fund, etc.).
- The second are investments in areas of particular importance, as listed in Annex II (e.g. dual-use items, military equipment, critical technologies – including artificial intelligence, robotics and autonomous systems – critical medicines, and certain entities and activities in the financial system).

In addition, national authorities should have the power to screen investments not falling under the two categories ex officio for 15 months after a transaction closes.

The proposal also lays down unified screening criteria for assessing whether the investment will "likely negatively affect security or public order". Aspects to be considered include the security, integrity and functioning of critical infrastructure, the availability of critical technologies, the continuity of supply of critical inputs, the protection of sensitive information and the freedom and pluralism of the media, as well as various factors related to the investor (e.g. related entities, previous approval history, or sanctions status).

Again, it seems doubtful whether this will lead to changes for businesses. Relevant are still the national regimes. There could be some (limited!) additional legal certainty in those member states that simply copied/pasted the extremely broad criteria under the current framework (and those are interpreted differently).

Alignment of Multijurisdictional Transactions

The proposal seeks to enhance cooperation among national screening authorities. For example, it lays down the minimum scenarios in which member states must notify transactions to the EU cooperation mechanism. This will be the case for (i) all investments covered by Annex I, (ii) high-risk investments covered by Annex II (e.g. those involving state-controlled foreign investors or investors associated with sanctioned entities), (iii) investments going into phase II review, or (iv) investments subject to mitigating measures or a prohibition already in phase I. This replaces the previous regime, which also required the notifying of FDI screenings but was applied differently across member states.

Further, the proposal lays down a coordinated procedure aimed at member states giving due consideration to comments from other member states or the European Commission. For example, member states will have to provide written reasoning for any disagreement with the received comments and will not be able to complete the screening prior to the expiry of deadlines for comments. For businesses, this will likely mean additional delays as national ministries or authorities will now have to draft a reasoning – which is likely an obligation without teeth since the decision is taken at a national basis.

Special rules are envisaged for multijurisdictional investments requiring parallel screenings in member states. In such cases, applicants will be required to make all filings on the same day, with appropriate references.

It is true that businesses seek harmonisation of the rules as FDI review has become ever more burdensome. The proposal does not address those concerns but, on the contrary, adds an impractical obligation on businesses.

Conclusion and Outlook

If the proposal becomes law in its current form, we will likely see an increase in the number of notifications that go through the EU process, creating further administrative hurdles and possibilities for delay. However, with many countries with high M&A activity already having developed FDI screening mechanisms, the practical implications of substantive changes (e.g. aligned scope and screening standards) will likely remain limited.

The most visible change is likely to happen at procedural level for transactions impacting several member states. By reinforcing the EU cooperation mechanism, the proposal seeks to address cross-border implications at EU level while, at the same time, keeping the screening local and allowing member states to protect their security and public order. Alignment is also supposed to provide certainty to potential investors. Time will tell whether these aims will be achieved. On the flip side, enhanced EU cooperation could lead to suspended review timelines to allow for coordination as well as to additional planning complexities and costs for investors due to the "same-day" notification requirements.

The proposal still needs to pass the ordinary EU legislative procedure, and not all of the proposed changes will necessarily make their way to the final text. Also, once adopted, the European Commission foresees a transitional period of 15 months before the rules become fully effective. With this in mind, the new rules are unlikely to apply for another few years – but with nothing stopping the member states from starting to implement changes in advance and in anticipation.

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