CELIS Issue Note on a firm-level perspective on investment screening in the EU

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Introduction

The CELIS Forum (CFIS) is Europe's first and foremost platform to discuss foreign investment screening. In light of the recently announced Proposal ('the Proposal') on the screening of foreign investment in the Union and repealing Regulation (EU) 2019/452, this year's Forum is uniquely placed to discuss, among others, the most pressing strategic issues that the Proposal seeks to address as well as highlight those issues that might have been overlooked.

What is and what is not a pressing issue of course depends on the perspective of the different stakeholders that populate the field of investment screening. After all, the explicit aim of investment screening is to hand EU Member States and the Commission the legal toolbox to safeguard security and public order, while domestic and foreign firms find themselves navigating an increasingly complex regulatory field that has the potential to curtail access to much needed capital. It is the balance between security and retaining an attractive investment climate that demarcates the tension at the heart of many discussions when it comes to investment screening. A second balancing act is that between the Commission and the EU Member States, where the former pursues more harmonization on investment screening but is dependent on the cooperation of the latter. Thinking along these lines allows for the isolation of a few important strategic issues that will need to be addressed in the upcoming Proposal and in the years that follow.

Balancing security needs and firm-level concerns

How can the regime address gaps in the Regulation **without increasing compliance costs** in the form of increased bureaucratic red tape and excessive notifications and screening reviews? The aim of the Proposal is to fix some of the shortcomings that have become apparent in the first 5 years of the Regulation's existence. For example, EU Member States that do not have a screening mechanism receive significant shares of FDI essentially

"unscreened".[1] There is also the concern that the current system does not capture all risky investments in screening states, in particular greenfield investments and *indirect* foreign investments made through EU subsidiaries controlled by non-EU actors.

The solutions proposed in the Proposal range from making investment screening mandatory for all EU Member States (not a contentious element), adding indirect foreign investments to the scope of application, introducing a mandatory sectoral scope for investment screening (Annex II), to including greenfield investments in the Proposal. These latter solutions leave significant room for debate, and are more contentious than the inclusion of the obligation to adopt a screening mechanism.

For starters, the inclusion of a mandatory scope and to allow for the screening of indirect foreign investment screening may have the very real potential of overburdening domestic FDI screening authorities and scaring off investors as they introduce more red tape for more businesses by increasing notification obligations.[2] Similarly, firms fear that the introduction of indirect foreign investment screening will lead to a much larger proportion of transactions subject to screening as it would practically apply to many intra-EU transactions, potentially leading to excessive administrative costs and more strain on bureaucracies that deal with an increase in screening cases, delaying the domestic screening process.[3] Some businesses in response have proposed that the Commission develop an approach to investment screening that is more targeted with a risk-based filter to exclude low-risk investments from the Proposal.[4]

How to balance the need to detect high risk investments currently not covered by domestic or EU Regulation, while excluding the low-risk transactions, has been an important discussion point. Doing so requires more definitional clarity than the Proposal currently possesses as Annex II of the Proposal (which contains the list of sectors where screening is set to become mandatory), is very vague and broad in scope.[5] For many businesses, therefore, delineating the scope of mandatory notification is central to achieving a manageable balance between

[1] European Court of Auditors (2023).
[2] https://www.linklaters.com/en/insights/blogs/foreigninvestmentlinks/2024/january/eu-published-fdi-reforms.
[3] Contributions to Commission feedback on the proposal that explicitly mention 'delays', 'costs', & 'burden' in the context of compliance costs: Medef, Business Europe, CMS, Allen & Overy, Svensk Näringsliv, ITI, Fund Apps, AEGIS Europe, VDMA, Austrian Federal Economic Chambers, ITI, ESF, AmCham, ESPO (15 out of 20 contributions). See also SWD (2024)23.
[4] Contributions to Commission feedback on the proposal that explicitly call for a more 'targeted' or 'risk-based' approach: CMS, ITI, FundApps, AmCham EU, ESPO, ESF (6 out of 20 contributions).
[5] Contributions to Commission feedback on the proposal that explicitly mention 'Annex II' in the context of legal uncertainty: VDMA, ITI, ESF, Amcham, Business Europe, CMS, ASD (7 out of 20).

ensuring the cost of FDI screening does not exceed the security gains it seeks to achieve. This is also apparent from the calls of national business associations to their governments when these adopted their own screening mechanisms.[6] Yet, it is unclear how sectors could or should be defined in order to address firm concerns and achieve a more risk-based approach.

Another aspect central to firm-level concerns is the **lack of transparency of the review process**. As it stands, EU Member States are only required to provide high-level information in aggregated and anonymised format in their annual reports, which fails to provide the necessary actionable guidance on interpretation of jurisdictional concepts, approach to substantive assessments and underlying reasons for remedial enforcement and prohibitions.[7] Similarly, there is (depending on the Member State) only limited interaction with the actors undergoing a review. Moreover, since many Member States don't have a long tradition of investment screening and as a result of the confidentiality of the review process, there are not many cases that can act as a guide to better understand the screening process, its outcome, and applicability. Combined, this makes that investment screening right now often still remains a black box for investors, domestic firms, and lawyers, creating uncertainty in the investment and deal-making process. This is particularly the case for small and medium sized firms, who often don't even have access to existing know-how on investment screening that is available, for example through larger law firms.

Moving forward, especially in the implementation phase of new legislation, attention should be paid to finding ways to increase transparency of the review process without prejudice to the need for confidentiality in individual cases or the state's prerogative to screen cases to ensure national security. How to do so will require including domestic stakeholders such as firms & legal representatives in domestic conversations on investment screening.

Harmonization and cooperation

National screening mechanisms vary significantly across the EU, which has both practical implications for firms as well as security implications for different Member States and the EU as a whole. How can the regime **become more harmonized**?

For reasons of security this variation in screening mechanisms is problematic because investment in one country has the potential to undermine security in another or deteriorate the EU's collective security situation, even when the host State itself is not affected per se. This is

[6] Doppen et al., 2024.
[7] See AmCham contribution.

where cooperation between the EU and its Member States and between the EU Member States themselves becomes very relevant: Accountability mechanisms, communication on decisions taken in a review case, streamlining the notification procedure to the cooperation mechanism provided by the EU Screening Regulation, streamlining domestic time-lines, are all proposed solutions to improve cooperation in safeguarding security and public order in the EU.

For firms, the variation of rules between different Member States has created the opportunity for regulatory arbitrage where foreign firms might focus their investments on those environments with more lax screening regulation. This has been confirmed by an audit commissioned by the EU that points out that much investment is flowing into States that have only limited or no investment screening. Domestic firms have confirmed that they worry about their country's attractiveness for FDI compared to other economies, as they fear the FDI they seek might be diverted to lean investment control regions.[8] Moreover, the variation between Member States also becomes highly relevant for firms when they face multi-jurisdictional filings, i.e. when an investment needs to be screened by multiple member states, increasing administrative costs and delays in the transaction.

Many stakeholders are not opposed to increased harmonization,[9] although they fear that the Proposal does not do enough to minimize divergence between Member States, neither on the domestic procedural side (timelines, information requested, decisions, etc.) nor when it comes to harmonizing the sectoral scope, as Annex II still allows for significant interpretation by Member States.[10] Achieving more harmonization will therefore require a significant amount of cooperation between Member States, also beyond the adoption of the Proposal.

Conclusion

The pace at which investment screening in the EU has evolved over the past year represents an important shift for firms when it comes to their economic activities and business strategies. The reality is that many firms are forced to increase their awareness of their own strategic position in their supply chains, sectors, and countries. This means that they too, have to adapt and consider how to align their own expectations and strategies within this new geoeconomic playing field.

[8] CIPE analysis by Sarah; interview with lobby group.
[9] See SWD(2024)23.
[10] Contributions to Commission feedback on the proposal that explicitly 'divergence', 'variation' & 'Single market' in the context of the proposal's ambitions: Amcham, ICLA, ITI, ESF. See also SWD(2024)23.

For this reason it is important to include firms in the conversations on some of the strategic issues that moving forward will need to be addressed. First, how can the cost of investment screening be kept as low as possible? Second, how can states increase transparency without prejudice to the need for confidentiality? And lastly, how can more harmonization be achieved in light of Member States' prerogative to screen investments how they see fit? At CFIS 2024 it is the aim to discuss these questions, and many more pressing issues in the field of investment screening.