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European Commission Publishes Third Annual Report on EU Foreign Direct Investments

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On 19 October 2023, the European Commission (EC) published its **Annual Report on the screening of foreign direct investments into the Union**, covering the year 2022. This is the third annual report published by the EC since the European Union's Foreign Direct Investment (FDI) Screening Regulation became fully operational in October 2020. Below, we summarise our main takeaways and the outlook for the road ahead.

EU Member States adopt and enhance FDI screening regimes

Three years ago, in 2020, only 15 out of 27 EU Member States maintained a system to safeguard against potential national security risks associated with third-country investments. Today, 21 Member States have domestic FDI screening regimes, with the remaining six –Bulgaria, Croatia, Cyprus, Greece, Ireland and Sweden – either currently working on draft legislation or soon adopting their own FDI screening regimes. In fact, the new Swedish system is due to come into force next month (on 1 December 2023), and Ireland recently passed its Screening of Third Country Transactions Act in October 2023, which is expected to be operational in Q2 2024.

However, despite the increase in FDI regimes and the EC's efforts to set minimum standards for these national regimes, there remain significant differences among the various Member States' systems – with notable discrepancies relating to timelines, sectoral coverage and notification requirements. This is not unsurprising, given that issues of national security remain a Member State prerogative, although that prerogative must be exercised in line with EU law.

EU FDI cooperation mechanism frequently used, but areas for improvement remain

The EU FDI Screening Regulation created a cooperation mechanism for Member States and the EC to exchange information, raise security-related concerns and identify solutions concerning specific FDIs with a view to ensuring the protection of security and public order. Since the creation of the cooperation mechanism, the EC has screened more than 1,100 FDIs.

In 2022, 17 Member States submitted a total of 423 notifications to the EC under the cooperation mechanism, whereas in 2021, only 13 Member States participated. The EC assessed 81% of these cases in Phase 1 reviews within 15 calendar days. Only 11% of cases proceeded to Phase 2, with additional information being requested from the notifying Member State – including information to better assess the criticality of the target company and/or the potential threats posed by the investor (such as information on the products and/or services of the target company, alternative suppliers and market shares, influence of the investor on the target company after the transaction, and additional defining characteristics of the investor and its strategy). The duration of Phase 2 proceedings varied significantly, from one to 126 calendar days, which is attributable to the information requested from the parties. The sector subject to the highest number of Phase 2 investigations was manufacturing (59%), which is unsurprising given that it covers a diverse set of industries.

The main countries of investor origin were Canada, Cayman Islands, China, Japan, UK and US. The proportion of US and UK investments was reduced, compared to 2021, from 40% to 32% (US) and from 10% to 7.6% (UK). Similarly, the proportion of

China-originating investments dropped, from 7% to 5.4%. Around 40% of notified cases originated from countries other than the top six, compared to 2021, where the share was only 29%. This marks a clear increase in the diversification of origin of the ultimate investors. This also is reflected in the fact that in 2022 ultimate investors originated from 52 different countries.

Number of formally screened transactions has increased, yet risk of intervention is low

In total, Member States handled 1,444 authorisation requests and ex officio cases in 2022. Of these, more than half (around 55%) resulted in a formal screening procedure, compared to 29% in 2021. The vast majority (86%) of formally screened cases were cleared unconditionally, with only 9% of cases approved with conditions and 1% of cases blocked. The remaining cases were abandoned by the parties. These numbers suggest that FDI reviews entail mainly timing risks, with low risk of intervention or blocking. However, it is notable that around 45% of authorisation requests and ex officio cases did not result in any formal screening and/or were deemed ineligible. This shows that the scope of some FDI regimes remains disproportionately broad or unclear, resulting in parties taking a conservative approach and making precautionary filings, which can lead to unnecessary delays in deal timings, as well as costs for the parties involved.

Transactions involving manufacturing, information and communication technologies (ICT), and professional activities attract higher levels of scrutiny

In 2022, the main sectors subject to FDI screening were manufacturing (27%), ICT (24%) and professional activities (12%). Of these, manufacturing accounted for 52% of Phase 2 cases, which is not surprising given that it includes energy, aerospace, defence, semiconductors, health, data processing and storage, communication, transportation and cybersecurity.

Reforms ahead?

Further to the third annual report, the EC is expected to propose a separate report to the European Parliament and European Council on the functioning and effectiveness of the EU FDI Screening Regulation by the end of the year. To that end, the EC conducted a public consultation during summer 2023.

The consultation followed publication of a study by the Organisation for Economic Co-operation and Development (OECD) on the Framework for Screening Foreign Direct Investment into the EU, which raised some issues on the effectiveness and efficiency of the FDI Screening Regulation. In particular, some of the concerns raised by the study included (amongst other things) the variety in review timelines among the Member States' national screening regimes and difficulties with gathering information on transactions that are not undergoing screening or that are reviewable but have not been notified. It is likely that any revisions to the EU FDI Screening Regulation will seek to strengthen the cooperation mechanism and improve the sharing of information among national authorities and the EC. It also is likely that the EC may broaden the list of sensitive sectors under review and the information requested from national authorities. However, what is less likely is the requirement for all Member States to screen FDI transactions in a set period of time, as such a measure would be contrary to the principle of procedural autonomy of the Member States.

Any changes to the EU FDI Screening Regulation will come at a critical time, with increased geopolitical tensions and accelerated technological shifts. In June 2023, the EC published its Economic Security Strategy to minimise the risks arising from certain economic flows while promoting the EU's competitiveness. It is still very much in its early days, but any revisions to the EU FDI Screening Regulation are likely to play a key role in achieving the EU's strategy.

Key Contacts

Jonas Koponen Brussels	jkoponen@cooley.com +32 2 486 7545
Christine Graham London	cgraham@cooley.com +44(0) 20 7556 4455