REPLIES OF THE EUROPEAN COMMISSION

TO THE EUROPEAN COURT OF AUDITORS' SPECIAL REPORT

Screening foreign direct investments in the EU

First steps taken, but significant limitations remain in addressing security and public order risks effectively

Contents

This document presents the replies of the European Commission to observations of a Special Report of the European Court of Auditors, in line with Article 259 of the Financial Regulation and to be published together with the Special Report.

I. THE COMMISSION REPLIES IN BRIEF

The Commission welcomes the European Court of Auditors' (the ECA) special report on screening foreign direct investments (FDIs) in the EU. The report provides an overview of the actions taken by the Commission to establish a cooperation mechanism for the screening of FDIs by Member States following the entry into force of Regulation (EU) 2019/452 (the Regulation) in autumn 2020.

The Regulation was adopted at a time where the COVID crisis and geo-political tensions have brought security and public order concerns much more into focus. It established a framework allowing the Commission and the Member States to cooperate in assessing the risks that FDIs in the European Union may present on the grounds of security and public order in more than one Member State, in particular for some European projects and programmes. While the Requlation does not oblige Member States to establish a screening regime, between the moment when the Commission tabled the draft Regulation and now, the number of Member States doing so has grown from 11 to 21. Since the entry into force of the Regulation, more than 1100 investments have been notified.

The Regulation has been one of a number of strategic trade and investment measures that have helped to reinforce the security of the Union and its citizens. This process has been possible due to the close cooperation and trust which has been established between the Commission and the screening authorities in the Member States. The Commission has learnt lessons from the first three years of operation that are also picked up in the ECA report, which recognizes the progress but also underlines the challenges, notably in the design of the Regulation, which prevent it from being fully effective. The report recommends to the Commission to check national screening mechanisms against the minimum requirements set out in article 3 of the Regulation, when revising the Regulation to strengthen the FDI framework, and to ensure a more streamlined approach at national and EU level, to improve the cooperation mechanism and the assessments made by the Commission and to improve the quality of annual reporting.

Many of the issues identified by the Court are directly linked to design choices in the framework, established at a moment when Member States and the Commission lacked familiarity with the practical operation of screening from a European and a national perspective. Some issues result from the fact that the Regulation was intended to frame, but not to harmonise, national approaches to screening. This has led to differences in everything from the scope of what is assessed or notified to the timelines applied in different Member States to the same transaction. Finally, other issues reflect the inherent challenge in identifying risks or designing mitigating measures in situations, where risks and impacts on security and public order are inherently uncertain.

Addressing these issues can reinforce screening in the EU. It can be done, in particular, by ensuring that scarce resources are focused on the most important cases and that blindspots created either by the absence of screening in a Member State or differences in what is screened and notified are eliminated. More can be done to ensure a common understanding of key concepts and approaches between Member States, while preserving a degree of flexibility where needed. Where possible, the Commission's annual reports could provide some additional transparency in an area which by definition requires a high degree of confidentiality.

The Commission is actively working on these challenges. It has already started addressing some of the issues which do not require a legislative change, which have been identified during the audit and are reflected in the ECA's recommendations. For instance, it is making sure that the existing

templates and checklists for the assessment of individual FDI cases are effectively used by Commission staff in all involved services. With regard to situations where the same transaction is considered in several Member States (multi-jurisdiction cases), the Commission has stepped up informal efforts to coordinate between the Member States screening different legs of the same transaction, in particular to synchronise timelines as much as possible. With regard to risk assessments, the Commission will continue to work in line with the requirements of the current legal framework, while taking into account, where practical, the considerations flagged in the report.

In addition, as announced in the June 2023 European Economic Security Strategy from the Commission and the High Representative, the Commission intends to table a legislative proposal to revise the FDI Screening Regulation by the end of the year. This will provide an opportunity to address recommendations of the ECA which necessitate a legislative change, with due respect to the Commission's right of initiative.

II. COMMISSION REPLIES TO MAIN OBSERVATIONS OF THE ECA

1. Design of the FDI screening framework

The Regulation has allowed the Commission and the 27 Member States (irrespective of whether they have a screening mechanism in place) to assess more than 1100 FDIs into the EU. In the assessment of these cases, the Member States and the Commission have had the possibility to flag security or public order concerns to the Member State where specific FDIs are planned or have been completed, by means of formal comments or, in the case of the Commission, opinions. This is an improvement compared to the situation prior to the entry into force of the Regulation, where transactions, when screened, were screened by Member States in isolation, without any awareness of the potential effect that they could have on other Member States' security or public order. The latter often did not know about transactions which could impact them, and when they were aware, they had no secure route to flag a concern to the screening Member State.

However, as underlined by the ECA[1], the design of the Regulation, which does not harmonise the conditions under which Member States screen FDIs, can in certain circumstances mean that the cooperation mechanism does not spot and address all risky investments.

For instance, the Regulation leaves the Member States free to choose not to adopt a screening mechanism. The absence of a screening mechanism in some Member States makes the EU's security and public order vulnerable to potentially risky FDIs. Also, as pointed out by the ECA, the Regulation does not require all Member States which have a screening mechanism to screen the same type of FDIs, nor FDIs ensure that investments in the same economic sectors are covered across the Union. The difference in scope between the national screening mechanisms also creates blind spots at the expense of our collective security[2].

Moreover, the Regulation, which was adopted under Article 207 TFEU, only covers Foreign Direct investment as defined by the CJEU, i.e direct investments made by investors from third countries into the EU. Foreign investments made by a foreign-owned or controlled undertaking already established

[1] Point 27 of the audit report

[2] Point 33 of the audit report

in the EU are not covered by the Regulation, unless there is a clear circumvention of the screening mechanism[3]. However, such investments made by undertakings established and economically active in the EU may present similar risks to security and public order[4].

Finally, as underlined by the ECA, the current framework does not provide sufficient assurance of how the Member State deciding on a transaction has taken into account security or public order concerns expressed by other Member States or the Commission[5]. An obligation to provide feedback on how concerns have been addressed would be a welcome improvement to the current system.

2. The latitude left to Member States national screening mechanisms and the compliance of those mechanisms with the EU framework

The Regulation sets out a number of basic requirements that all national screening mechanisms must fulfil. It also requires Member States that have a screening mechanism to notify to the cooperation mechanism all FDIs that they screen. However, beyond these basic requirements and obligations, Member States remain free to determine key features of their national screening mechanism. For instance, Member States may decide on the sectoral scope of their FDI screening mechanism. They may decide to screen more than FDIs as defined by the Regulation. They may decide on the timeline for their assessment and the moment in time, in their procedure, when they notify FDIs to the cooperation mechanism[6].

The Commission agrees with the ECA that the intrinsic features of the Regulation, which the ECA qualifies as an 'enabling' rather than 'harmonising' regulation, together with the various interpretations of definitions set out in the Regulation at national level, have resulted in differences between the Member States in how they handle cases[7]. This has also resulted in ineligible and obviously non-critical cases being notified to the cooperation mechanism[8]. As a result, the cooperation mechanism may dedicate disproportionate resources to less risky transactions, while reducing capacity to focus on FDIs with more significant impacts on the EU's security or public order. This may be compounded by the tight time limits, particularly, for the Commission to complete its assessments.

That said, the existence of tight timelines and the fact that 89% of the cases are closed by the Commission after only 15 calendar days, shows that the system has not unduly delayed the completion of transactions, nor has it been at the cost of making a proper assessment of the case.

Lastly, the ECA correctly points out that the Commission has not assessed the compliance between national screening mechanisms and the basic requirements set out by the Framework[9]. In the first years of operation, on the one hand, the screening landscape has been in flux and new systems have been created and some existing systems updated, which would have meant the Commission would have been assessing a moving target, which would not have been an optimal use of resources. On

[3] The scope of the Regulation was recently confirmed by the CJEU (C-106/22)

[4] Point 29 (d) of the audit report

[5] Point 27 of the audit report

[6] Point 33 of the audit report; albeit they have to notify "as soon as possible" pursuant to Article 6(1) of the Regulation.

[7] Points 34 and 35 of the audit report

[8] Point 36 of the audit report

[9] Point 32 of the audit report

the other hand, the Commission has had to reach cruising speed in terms of assessing cases within the deadlines set out in the Regulation, while ensuring the necessary infrastructure and support to the process within the Commission and with Member States. The Commission agrees with the ECA that assessing the compliance of the national screening mechanisms with the basic requirements of the Regulation is an important task in achieving a common understanding with Member States, aligning approaches and playing its role in ensuring the framework operates in line with the Regulation.

3. Opinions issued by the Commission under the Regulation

The Regulation gives the Commission the possibility to issue opinions in three scenarios. First, the Commission can issue an opinion if it comes to the conclusion that a particular FDI is likely to impact the security or public order of at least two Member States. Second, it can issue an opinion if it comes to the conclusion that a particular FDI is likely to impact a project or programme of Union interest on the grounds of security or public order. Third, it can issue an opinion if it has relevant information to share with the Member State where an FDI is planned or has been completed.

Since the entry into force of the FDI screening regulation, the Commission has issued opinions in less than 3% of the notified cases. Within that group, the share of opinions identifying a likely impact on the security or public order of the EU or at least two Member States is even smaller, as some of the opinions adopted were ones sharing relevant information with the notifying Member State in situations where the Commission did not have sufficient elements to establish a likely impact on security or public order. The Commission believes that it has issued opinions in all appropriate cases, following an approach which reflects the openness of the Union, where restrictions due to the security and public order are an exceptional, but justified case; an exception that should be interpreted strictly.

The Commission welcomes the finding by the ECA that the Commission is ideally placed to assess the likely impacts on public order or security of FDIs involving several Member States and/or on projects or programmes of Union interest[10]. The ECA stressed that the Commission provides comprehensive descriptions of the risks at stake, and that Member States appreciate the assessments made by the Commission.[11]

Due to the sensitive nature of the interests at stake, which relate to security and public order, the Commission's opinions issued under the Regulation are classified documents. They, nevertheless, are prepared in compliance with the legal requirements of the Regulation, EU law and its general principles, the international commitments of the EU and the duty to ensure the opinions are duly motivated. Of course, they are prepared and adopted on the basis of the limited information available to the Commission at the time when they are issued, and subject to the very tight timelines currently provided in the Regulation. Inevitably, this places constraints on the depth of analysis that may be possible in a given case. We note the comments of the ECA regarding our opinions. In some cases, gaps identified by the ECA result from the design of the current regulation. The Commission believes that it is not always possible to quantify the likelihood of risks related to public order and security, and that a risk assessment can only rest on a set of indicators, rather than evidence. In all cases, the Commission seeks to base its case-by-case analyses on the informationavailable. Whilst intervention under FDI screening should be proportionate and to the extent possible compatible with a market economy, the objectives of FDI screening are not to protect competitiveness but to protect our collective public order and security.

[10] Point 45 of the audit report

[11] Point 44 of the audit report

4. Tools, resources and reporting

The Commission welcomes the ECA's appreciation of the resources, the internal databases and procedures and the secure channels of communication put in place by the Commission.[12] As stressed by the ECA, these tools have allowed the Commission to process a high number of cases within the cooperation mechanism and to make its assessments of every case within the tight deadlines set by the Regulation. The Commission appreciates the ECA suggestion to make a more systematic use of the tools developed by the Commission, which is also recognition of their usefulness.

The Commission also agrees that the annual reporting on the implementation of the Regulation could be further improved[13], though with due respect to the confidential nature of the information that the Commission has at its disposal, including the information received from the Member States.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS OF THE ECA

Recommendation 1 – Seek the necessary amendments in the Regulation to strengthen the EU FDI screening framework

Without prejudice to the decisions of the co-legislators, we recommend that the Commission should in its revision of the framework:

a) include the requirement that all member states establish screening mechanisms.
b) clarify key concepts such as: — the definition of 'likely' risk by aligning it clearly to the notion of "genuine and sufficiently serious threat to a fundamental interest of society"; — portfolio investments;
c) cover explicitly: — investments made in the EU by a foreign-owned undertaking economically active in the EU; - investments, whereby a foreign investor acquires a foreign target with subsidiaries in the EU;
d) include the obligation for member states to provide the Commission and other member states, as the case may be, with feedback on the outcome of their screening decisions, in particular where the Commission has issued an opinion and/or the respective member states have provided a comment.

Target implementation date: 2024.

As regards the target implementation date, the Commission will consider addressing these recommendations in its legislative proposal that it expects to table by the end of 2023, with due respect to the Commission's right of initiative. However, the Commission cannot prejudge the content of future legislative proposals.

The Commission **accepts** recommendation 1(a).

[12] Points 51-56 of the audit report

[13] Point 57 of the audit report

The Commission has on several occasions called for the establishment of a national screening mechanism in all Member States, even if this is not a legal requirement under the Regulation. The Commission agrees that making the establishment of a screening mechanism in all Member States mandatory would accelerate the observed trend where those Member States without a screening mechanism have taken some steps towards establishing one.

The Commission **does not accept** recommendation 1 (b).

The Commission does not consider the clarification of these definitions in the future legislative proposal necessary or appropriate.

The Commission **accepts** recommendation 1 (c).

The Commission intends to consider addressing this recommendation in the future legislative proposal..

The Commission **accepts** recommendation 1 (d).

The Commission agrees that strengthening the accountability of the Member State receiving a Commission opinion and/or a Member State comment would be a welcome improvement to the system..

Recommendation 2 – Assess whether national screening mechanisms comply with regulatory standards, and streamline concepts across EU screening mechanisms

The Commission should:

a) provide an assessment of whether national screening mechanisms comply with the standards set out in Article 3 of the Regulation;
b) clarify the practice of pre-screening; and
c) encourage member states to align their criteria, timeframes and processes so that cases spanning multiple member states can be coordinated effectively (multi-jurisdiction cases).

Target implementation date: for a) by 2026, for b) and c) by 2025.

The Commission **accepts** recommendation 2(a).

The Commission agrees to assess compliance of the national screening mechanisms with the minimum requirements set out in the applicable regulation by 2026. The exact timing may be conditioned by the progress of the future legislative proposal.

The Commission **partially accepts** recommendation 2(b).

The Commission intends to consider clarifying the concept of “formal screening” in the framework of its future legislative proposal, with due respect to its right of initiative.

The Commission **partially accepts** recommendation 2(c).

As regards the alignment of practice of Member States, the Commission has started doing so by reinforcing informal coordination of timelines of notification and provision of additional information between Member States in multi-jurisdictional cases. Where alignment requires legislative changes, the Commission intends to consider proposing additional measures in its future legislative proposal.

Recommendation 3 – Improve the cooperation mechanism and the Commission's assessments in order to provide better justification of mitigating actions relating to high-risk cases

The Commission should:

a) **assess eligibility before it starts risk assessments;**
b) **make risk assessments more comprehensive by exploring the scope for cooperation with Europol and Eurojust to assess criminal or security risks presented by individual investors;**
c) **in its assessments, focus on risks which are reasonably likely to occur, and avoid hypothetical scenarios;**
d) **strengthen its opinions by indicating clearly if the opinion is just for sharing the information or for addressing serious threats to security and public order and proposing proportional measures taking into account roles and responsibilities of investors, existing EU or national legislation, policies and instruments.**
e) **recommend prohibiting cases where foreign investors are on a sanctions list banning investment, irrespective of the risk profile of the target.**

Target implementation date: June 2024

The Commission **partially accepts** recommendation 3 (a).

In the majority of cases, the assessment of eligibility is straightforward and is made by the Commission within 48 hours of receipt of the notification. There are some instances, where the information available to the Commission at notification stage does not allow to conclude on eligibility, leading the Commission to assess eligibility and sensitivity simultaneously to be able to abide by the strict deadlines imposed by the Regulation in the event that the transaction in question proves eligible. The Commission believes, under the current design of the regulation, this is the most efficient and effective use of resources. The revision of the Regulation or FAQs will offer an opportunity to clarify certain definitions, which should help to significantly reduce the number of notifications of ineligible cases to the cooperation mechanism.

The Commission **accepts** recommendation 3 (b).

The Commission agrees to explore ways to draw on the information available for Eurojust and Europol within the limits of their respective mandates and provided confidentiality rules allow this, to the extent that they can provide information relevant for the assessment of specific FDI cases.

The Commission **accepts** recommendation 3 (c).

The Commission agrees, building on current practice and with due account of the time and access to information constraints under which it is operating, with the recommendation to focus on risks which are likely to occur in line with the applicable legal requirements.

The Commission **accepts** recommendation 3 (d).

The Commission agrees, building on current practice, to indicate clearly to the Member State(s) to which an opinion is addressed if that opinion is sharing relevant information or identifying a likely cross-border impact on security and public order, and ensure its opinions respect the general principle of proportionality.

The Commission **partially accepts** recommendation 3 (e).

The Commission accepts that when an investor is listed under EU sanctions prohibiting an investment, the transaction should not go ahead. Where such a situation exists, the Commission will draw the relevant Member States' attention to that fact, either through an opinion or by other means, as appropriate. The primary responsibility for ensuring compliance with such sanctions remains with the Member States.

Recommendation 4 – Improve the quality of reporting

The Commission should improve the quality of its annual reports by focusing on critical risks and approaches to mitigating them. In cooperation with member states, it should also improve the scope and quality of the underlying data.

Target implementation date: 2024

The Commission **partially accepts** recommendation 4.

The content of the annual reporting is partly defined by article 5 of the current Regulation, which describes what should be covered in annual reports. The Commission is ready to improve its reporting in collaboration with Member States also within the context of the cooperation mechanism. To the extent that future legislative changes are required to improve reporting, the Commission will consider including this in its future proposal.