

Brussels: 12 January 2018
Concerning: Proposal for establishing a framework for screening of foreign direct investments in the European Union

Dear Sir, Madam,

European Investors' Association ("**European Investors**") welcomes the opportunity to comment on the Proposal for establishing a framework for screening of foreign direct investments in the European Union ("**Proposal**").¹

The Proposal includes:

- (1) The establishment of a European legal framework for screening of FDIs by Member States on the grounds of security or public order;
- (2) A cooperation mechanism between Member States and the Commission which can be activated when a specific foreign investment in one or several Member States may affect the security or public order of another Member State;
- (3) European Commission screening on the grounds of public order for cases in which FDIs in Member States may affect programmes of Union interest;

By way of background, European Investors represents the interests of investors throughout Europe.

1. General remarks

As the global industry is on the brink of a new technological era due to the combination of artificial intelligence, modern communication, big data and cloud computing, new investment trends are accelerating in the European Union ("EU"). Investors from emerging economies, sometimes massively state-backed, are playing a growing role as FDI-providers with a particular strong interest in high-tech companies and advanced manufacturing assets, mainly semiconductors and robotics.

Apart from the risk that EU companies can lose their technological and competitive edge to foreign competitors, such investment could enable foreign control over critical infrastructure in Member States and facilitate transfers of dual-use technologies with potential implications for geopolitical and security interests for Member States in particular and the Union as a whole. These risks could have a cross-border impact while there is no comprehensive framework for screening on the grounds of security or public order at EU

¹ <http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-487-F1-EN-MAIN-PART-1.PDF>

level. Only half of the Member States has screening mechanisms in place with different approaches as regards the exact scope and design of the procedures.

Considering the above, European Investors supports the general idea to establish a framework for screening of foreign investment on the grounds of security or public order. We understand the Union needs to identify and manage risks to its most critical assets in the face of espionage, sabotage and coercion. Nevertheless, strict safeguards need to be included to ensure the framework is transparent, effective and above all proportional. European Investors foremost urges to strike a clear balance with the EU's free trade principles. We want the EU to remain a leading and attractive destination for foreign investment. FDIs connect European companies to their global markets and supply chains and are an important source of jobs, growth and innovation. The Proposal should not discourage foreign investment in non-strategic sectors and in companies which are part of strategic sectors but whose acquisition would have no security implications. Also, the Proposal should ensure that the framework gives no authority to the Commission or the Member States to screen FDIs which do not pose a threat for security or public order.

Therefore, and to safeguard its effectiveness and legal certainty, the Proposal should make it unmistakably clear in what cases a foreign investment could pose a risk to security or the public order and which grounds could trigger a screening procedure by the Commission or one or more Member States. The Proposal has to provide crystal-clear criteria to determine which sectors and companies will be covered by the framework, enabling investors to integrate this information in their decision-making and risk analysis. Moreover, there should be no unexpected expansion of strategic sectors which are covered by the Proposal.

In addition to these general remarks, we would like to share some specific concerns with regard to the Proposal which mainly focus on its scope, design and overall clarity.

2. The Proposal itself should provide clear definitions of FDIs and foreign investor

Article 2 provides definitions for the concepts of foreign direct investment and foreign investor. European Investors is concerned that both these definitions are susceptible to circumvention.

- In article 2.1, foreign direct investment is defined as 'investments of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity'.

European Investors recommends to be more specific with regard to several elements of the definition. It is not clear what 'lasting and direct links' entail. When is a foreign investor 'aiming to establish lasting and direct links' and does 'any kind of investment' also include cooperation agreements? European Investors also requests

to clarify whether the definition of foreign direct investment covers joint ventures, venture capital funds, licensing agreements and other arrangements that enable access to sensitive assets by foreign investors. In addition, it is unclear to us what 'enabling effective participation' exactly is. This should be clearer as well.

- European Investors also has concerns with regard to the definition of foreign investor. According to article 2.2, foreign investor means 'a natural person of a third country or an undertaking of a third country intending to make or have made a foreign direct investment'. According to article 2.5, 'undertaking of a third country' means 'an undertaking constituted or otherwise organised under the laws of a third country'. European Investors recommends to provide further clarity whether the definition also covers investors which are indirectly owned, funded or controlled by a foreign government or its related agencies. In this regard, it should be clearer to the market if the definition of foreign investor also covers the use of reversed mergers, various types of shell companies and greenfield investments (a parent company builds its operation in a foreign country from inception). In its 2017 Annual Report to Congress, the U.S.-China Economic Security Review Commission commends to review investments of shell companies and greenfield investments from third countries.² We recommend to take note of this recommendation.

3. The Proposal should provide definitions of security and public order

The Proposal creates an enabling framework for Member States to screen foreign direct investments on the grounds of security and public order. However, these are quite vague concepts which could be wide open to interpretation. As a result, investors will be in the dark which sectors and companies will be covered by the Proposal. Furthermore, Member States could misuse the framework on political grounds, for example as a delaying tactic to thwart competition (from another Member State). Therefore, we recommend to provide strict definitions of security and public order in the Proposal itself.

4. The scope of Article 4 should be limited to provide more clarity to investors

Article 4 provides an overview of potential effects that may be taken into consideration in the screening of a foreign investment. These include 'potential effects on critical infrastructure, critical technologies, security of supply of critical inputs or access to sensitive information or the ability to control sensitive information'. In addition, Member States and the Commission may take into account whether a foreign investor is controlled by the government of a third country including through 'significant funding'. Although the article provides some examples of sectors which are covered by the Proposal, European Investors feels the 'non-exhaustive' list fails to meet its goal to provide sufficient clarity to investors intending to make or having made FDIs in the Union.

Therefore, we have the following suggestions:

² https://www.uscc.gov/Annual_Reports/2017-annual-report

- The Proposal should provide more clarity with regard to the definitions of ‘critical inputs, sensitive facilities, critical technologies and communications’. According to the list as currently provided in article 4, a potentially wide range of sectors and companies could be affected. As a result, investors are kept in the dark as they cannot integrate crucial information in their decision whether to invest in a company or not. Apart from requesting further clarification, European Investors also recommends to require the contact points (which have to be established by Member States on the basis of article 12) to prepare and update a list of critical technologies, critical inputs and critical infrastructure and of companies active in these sectors which would not be eligible for acquisition or investment - at least for listed companies - and publish these lists on their websites.
- It is unclear to European Investors which critical technologies will be classified as technologies with ‘potential dual-use applications’. We request more clarity with regard to the definition of potential dual-use.
- The Proposal should provide more clarity with regard to the definition of ‘critical infrastructure’. Although article 4 provides examples of sectors which could be covered by the Proposal, investors will be provided with even more clarity when the Proposal would give a clear definition of the concept of ‘critical infrastructure’. In this regard, the Commission could consider the definition of critical infrastructure used by the Trusted Information Sharing Network: ‘those physical facilities, supply chains, information technologies and communication networks which, if destroyed, degraded or rendered unavailable, would significantly impact the social wellbeing of the nation or affect Australia’s ability to conduct national defence and ensure national security’.³
- Article 4 provides examples of critical infrastructure. European Investors requests clarification whether this covers companies from the biotechnology, agriculture, biopharma and public health sectors as these are not mentioned in the examples.
- Article 4 mentions access to sensitive information or the ability to control sensitive information as a factor that may be taken into consideration by Member States. With cyber space and artificial intelligence on the rise and its machinery and software applications making inroads in a growing variety of economic sectors, access to or the ability to control sensitive information will no longer be limited to defence industries. To ensure that article 4 is sufficiently future proof and to prevent a confusing patchwork of interpretations across Member States, the article should provide a clear definition of ‘sensitive information’ and an indication of cases in which the ability to control such information is considered to be a risk for security or the public order.
- Article 4 stipulates that in determining whether an investment is likely to affect security or public order ‘Member States may take into account whether the foreign investor is controlled by the government of a third country, including through

³ https://www.tisn.gov.au/Pages/Critical_infrastructure.aspx

significant funding'. Although European Investors agrees that this should be taken into account because of the thin line between government and business in some emerging economies and the emergence of opaque investor networks, we doubt whether the limited provision in article 4 provides governments and market parties with sufficient clarity in this regard. We recommend to include a definition of control which covers influence on management, espionage, sabotage and coercion (influencing private business decisions to achieve state goals) to counter the inward nature of business and politics in some emerging economies. Therewith, the Proposal would provide investors with a more practical framework to determine whether a company has too close links with a foreign government or a government programme.

- Article 4 should be clearer about the scope of 'significant funding'. When is funding deemed to be 'significant' and does it apart from subsidies also include tax (incentives), preferential loans, national investment funds, guarantees and R&D funding provided by foreign governments?
- The screening framework should address how an acquisition is financed and whether an investing entity, for example a globally operating conglomerate, is financially stable and can be trusted with providing services in strategic sectors sustainably in the long term.
- European Investors recommends to include a review of the track record and reputation of a foreign investor as a step in the screening process.

5. Annex of EU projects and programmes should be more than indicative

The Proposal introduces the possibility for the Commission to screen FDIs which are likely to affect projects or programmes of Union interest on security and public order grounds. Such projects could be part of 'meaningful screening'. Projects of Union interest include in particular those of 'substantial EU funding', or established by Union legislation regarding critical infrastructure, critical technology or critical inputs. In order to ensure transparency and legal certainty, an 'indicative list' of projects is included in the Annex.

However, this automatically raises the question when EU funding is considered to be substantial. Also, European Investors feels that a list which is intended to ensure transparency and legal certainty has to be more than 'indicative'. It should at least provide a more in-depth overview of cases in which funding of an investment is covered by the Regulation.

6. The Proposal should be accompanied with an impact assessment

By exception, the Proposal is presented without an accompanying impact assessment. According to the Proposal, other elements will be further assessed in a study announced in the Communication accompanying the Regulation. This study would include an in-depth analysis of investment flows into the Union in particular those in strategic sectors or assets which may raise security or public order concerns. For now, the Proposal is only accompanied with a working document providing a factual description of foreign takeovers

in the EU on the basis of available data, as well as a brief analysis of the issue at stake. European Investors feels this is unsatisfactory for a Proposal that could have a permanent impact on the European business climate. An impact assessment is crucial to test its expected effectiveness. European Investors would welcome the Commission to publish an impact assessment as soon as possible.

7. Affected market parties should be consulted in evaluation

The Commission will evaluate the Regulation no later than three years after its entry into force in order to assess the actual impact and evaluate its effectiveness and the extent to which its results are consistent with its objectives. This evaluation could result in modifications to the Regulation. European Investors feels it would be appropriate if the Proposal is supplemented with a provision that industry and investor associations will be consulted in the future evaluation as this could improve the effectiveness of the framework. Additionally, we propose to evaluate the impact of the Regulation on public companies already after one year instead of after three years.

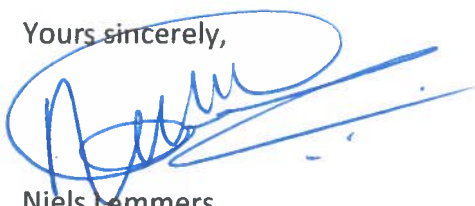
8. Annual reports of Member States should be made publicly available

Member States have to provide the Commission with annual reports on the application of their national screening mechanisms or – if they do not have a mechanism – on foreign direct investments that took place in their territory. These reports shall at a minimum provide information on investments subject to screening, including an indication of sector, origin and value of investment subject to screening, as well as information on screening decisions either prohibiting an investment or subjecting such investment to conditions. These reports contain valuable information for market parties to assess if a planned or completed investment is covered by the Regulation. Therefore, European Investors stresses these annual reports should be made publicly available on the website of the Commission or at the national contact points, of course with due observance of confidentiality requirements. Again, this could significantly improve the effectiveness of the framework.

9. Concluding remarks

Naturally, we would be more than willing to provide further written or verbal information in support of the above.

Yours sincerely,



Niels Lemmers
Managing Director



Pieter Hanson
Policy Advisor