Ashurst

Funds Insider

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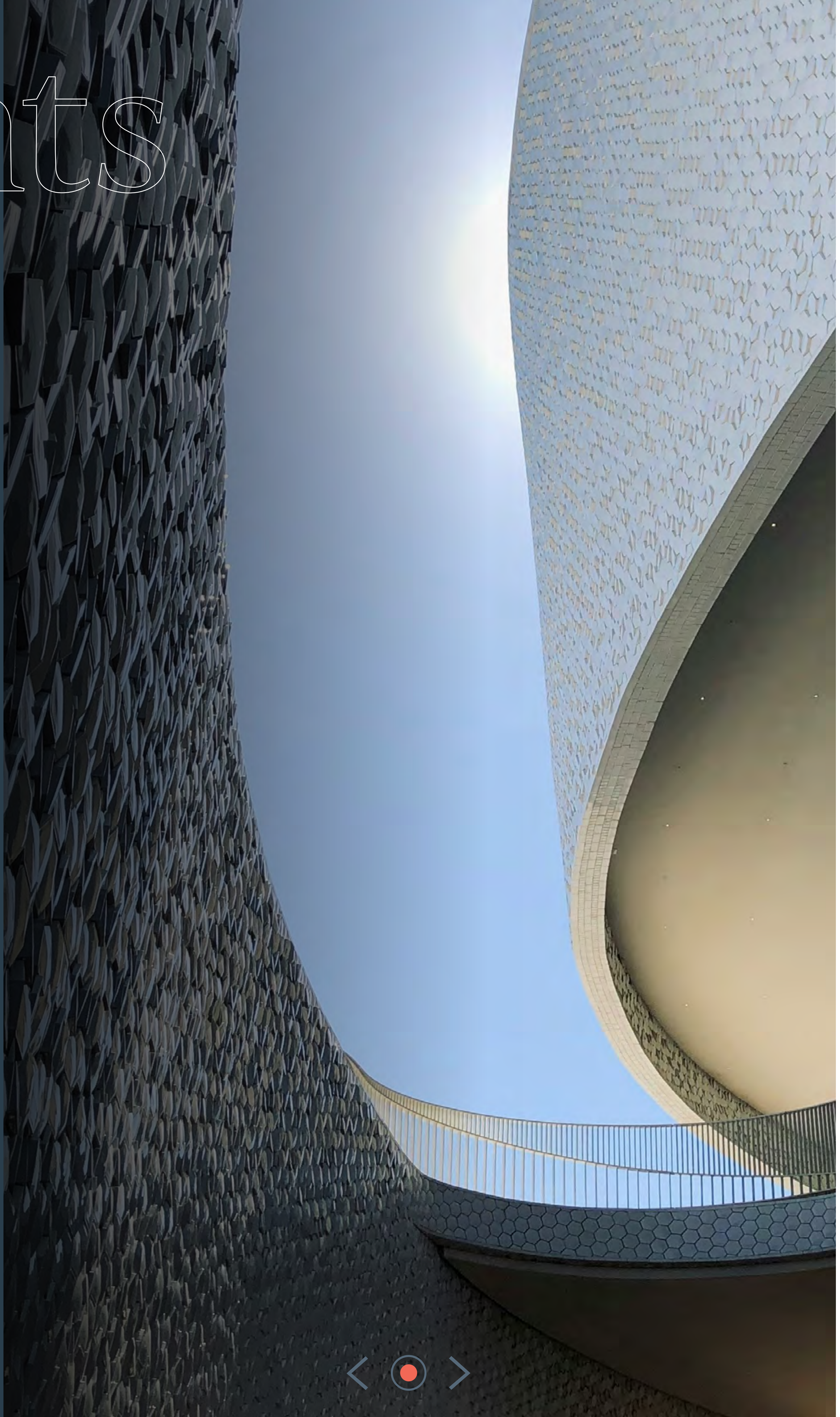
Outpacing change

contents



Foreword

Welcome to the Summer issue of Funds Insider, our quarterly publication dedicated to providing insights and analysis for our private capital clients.

In this issue, we begin by looking at the intersection of fund finance and securitisation, an area we have been advising on amidst growing interest from market participants. We then look at the European Non-Performing Loans (NPL) landscape, with a comparative overview of the Italian, French, German and Spanish implementation regimes.

Next, we provide a practical guide for the seven main issues lenders should consider when navigating 'Handover the Keys' transactions, which are becoming a notable feature in the current market environment. Finally, we provide an update on the evolving landscape of EU merger control and foreign direct investment (FDI) regulations, highlighting how these regulatory changes are impacting deal execution and strategy across Europe.

We hope you find this edition of Funds Insider both informative and engaging. Please do not hesitate to share your feedback or let us know if there are particular topics you would like us to address in future issues.

Funds Insider

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The intersection of fund finance & securitisation

By Theodoros Kotsiras

While the cross over of securitisation techniques and fund finance has been a point of discussion for market participants for a number of years now, activity in this space has been slow until recently.

The execution of a few novel fund finance securitisations on both sides of the Atlantic however, coupled with the growing liquidity and structural needs of private funds, regulatory pressures on banks, the rise of private credit and growing investor appetite now provide an ecosystem where the securitisation of fund finance receivables may assist both fund finance and structured finance participants to meet their strategic objectives.

Significant market focus in respect of securitisation and fund finance has been on securitisation of capital call facilities (though there are other areas of fund finance that are of relevance). Capital call facilities (also known as subscription line facilities) are short term lines of credit provided to private equity funds (or similar investment vehicles) to finance investments or expenses before drawing committed capital from its investors (i.e. its limited partners or LPs). Typically these are provided by banks and other large financial institutions. The uncalled capital commitments constitute the collateral for such facilities and consequently creditworthiness is determined on the strength of the LP commitments (thus analysing the quality of the largest LPs) rather than the fund's assets. Such facilities are then repaid using the proceeds from capital calls made to the fund's LPs (typically within a short period after the loan is drawn). Capital call facilities are meant to assist funds with quick access to cash, enabling faster deal execution and smoother capital management.

In this article we will provide a brief overview of the most common methods of securitising receivables, the regulatory landscape and the benefits of fund finance securitisations.

Methods of securitisation

Though securitisations may take many different structural and legal forms, traditionally in the European market they are structured as a "true sale" transfer of a portfolio of assets originated or previously acquired by the originating institution (which will often be a financial institution but may also be a corporate or fund) to a bankruptcy remote special purpose vehicle (an "SPV") with the SPV issuing tranched securities either to private investors (commonly known as a "private" securitisation) or in the public capital markets on a more widely syndicated basis (thus a "public securitisation"). The proceeds of such issuance are used by SPV to acquire such portfolio. Securitisations may also be structured for asset risk to shift from the originating institution synthetically, typically by means of a credit protection agreement as opposed to a sale.

In a traditional "true sale" securitisation model, typically the institution acting as originator will have used corporate debt and/or equity to originate (or purchase from a third party) the relevant assets which it will be holding at such time on its balance sheet and such assets will be sold to the SPV upon the closing of the securitisation.

Depending on the size of the asset pool and the type of asset concerned as well as market conditions, such assets may be securitised through a public issuance (of which as at the date of this article, there have been none in respect of fund finance receivables in the UK). Alternatively, originators may engage in private transactions, that is with one or more (senior and/or mezzanine) lenders with junior funding provided by the originator. Whereas traditionally originators securitised existing pools (in what is known as a "warehouse" transactions), in recent years other private funding securitisation models have become common such as "wet funding" and "forward flow" transactions (or indeed, securitisations that combine two or more of these methods). In forward flow transactions the SPV acquires the assets immediately upon origination on an ongoing basis and in wet funded transactions the lenders provide the financing in advance for the purposes of the asset being originated. The latter methods dovetail quite harmoniously with the nature of subscription line facilities both in terms of execution and duration. In addition, private securitisations can be static or revolving (i.e. principal from the underlying assets is used to fund the acquisition of additional assets as opposed to repay principal to the securitisation lenders if the securitisation is not in amortisation) which again may be aligned to the fund finance market and in particular capital facilities (given they typically have short term maturities).

While there have only been a limited number of fund finance securitisations in the UK so far, we have already seen transactions that have securitised both an original lender's participation in a capital call facilities and also a fund's exposures to investor capital calls through the above methods. In addition lenders have started using fully retained securitisations of capital call facilities for balance sheet management purposes. Thus while the market is still in its inaugural phases, there is an exciting number of deals and structures that are being developed.

Considerations for using securitisation for fund finance participants and investors

For originators, securitisations can be a useful tool in extracting value from their existing portfolios. Firstly, given securitised assets are derecognised from the balance sheet of the originator, these transactions can very helpful in the originator's balance sheet management (which in turn can allow the originator to scale its debt origination operations further). In addition, the originator may benefit from regulatory capital relief, again freeing up capital. Other benefits may include a reduction in respect of the originator's funding costs vis a vis equity or vanilla debt, immediate cost-effective liquidity and further diversification of its funding sources. Depending on how the transaction is structured (for example what is agreed commercially in respect of the concentration limits and eligibility criteria of the pool between the originator and the lenders) it can also be a help in the credit risk management of the originator in reducing its own exposure and concentration risks in respect of the assets. Originators also benefit from the economic upside of the assets (for example via servicing fees or any excess spread).

For investors, investing in securitisations of fund finance receivables allows them to gain indirect access to the fund finance market without needing to set up their own origination platforms. Investors may also find that securitisations backed by such assets provide a high quality credit exposure given that historically the default rates on LP capital calls are low. For traditional ABS investors, it also allows them to diversify their investment strategy by investing in a new asset class (that may not be as affected by macroeconomic risks as, for example, consumer ABS).

There are however certain nuances to the fund finance space that may act as barriers to this market. Transparency, which is always a key consideration for investors, may not actually be available or permissible (for example key metrics or historic data are unavailable compared to other typical asset classes and GPs in general are sensitive about the provision of information about them and their investors) to the extent that a typical ABS investor expects currently. In addition originators may also have to overcome certain other structural legal issues associated with this asset class such as any transferability restrictions in the underlying documentation. The market is also still evolving and there are no clear market precedents at the moment as to what are largely acceptable key commercial, asset pool and/or legal terms (such as eligibility criteria for example). In each case these are likely to develop over time given the overall attractiveness of the asset class.

Regulatory considerations

In order for a transaction to constitute a "securitisation" under the respective frameworks in the EU and the UK, namely the EU Securitisation Regulation[1] and the UK Securitisation Framework[2] (which are currently largely aligned in this respect), a transaction must meet certain conditions and if it does so then it will be subject to initial and ongoing obligations. While the full regulatory regime is nuanced and outside the scope of this article, the regulations define as "securitisation" any transaction or scheme where "the credit risk associated with an exposure or a pool of exposures is tranched, having all of the following characteristics:

- payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;
- the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme; and
- the transaction or scheme does not create certain exposures."[3]

Securitisation of existing securitisation positions (i.e. re-securitisation) is also prohibited.

Both the EU Securitisation Regulation and the UK Securitisation Framework place a number of obligations on "originators", sponsors, SSPEs (that is SPVs) and institutional investors. Some of those core obligations include:

- **Risk retention** - the retention of at least 5% of net economic interest in the securitisation by the "originator", the original lender or the sponsor for the life of the transaction through a variety of retention methods (most commonly through the retention of the first loss tranche). It is important to note that the regulations restrict which entity can act as "originator" within its regulatory meaning, requiring, amongst other things that such entity has economic substance and that its "sole purpose" is not to securitise exposures;
- **Transparency** - certain transparency requirements whereby the SPV and/or the originator must make available, amongst other things, asset level and securitisation level reports in prescribed formats on at least a quarterly basis along with reporting on significant events; and
- **Due Diligence** - due diligence requirements placed on investors which broadly require investors to carry out a due diligence exercise on the securitised portfolio and the securitisation structure as whole together with a verification of the credit-granting standards and processes of the originator.

Concluding remarks

Securitisation does appear to be a natural next step to the evolution of fund finance with the potential to unlock new opportunities for market participants. While this space is currently evolving, and has attracted considerable interest from market participants, it is still very much in its inaugural phases and it remains to be seen whether fund finance related receivables become a more standard securitisation asset class. At Ashurst we have seen continued growing interest from market participants in this area and have recently advised the investors on a novel private forward flow securitisation of subscription lines to mid-market private equity firms.

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1 EU Securitisation Regulation means Regulation (EU) 2017/1402 (as amended)
2 UK Securitisation Framework means the UK Securitisation Regulations 2024 (SI 2024/102) (as amended), the Securitisation Part of the rulebook of published policy of the Prudential Regulation Authority and the securitisation sourcebook of the handbook of rules and guidance adopted by the Financial Conduct Authority, together with the relevant provisions of the UK's Financial Services and Markets Act 2000 (as amended)
3 Exposures which possess all of the characteristics listed in Article 147(8) of Regulation (EU) No 575/2013

Implementation of the Secondary Market Directive: navigating the new landscape for NPLs

By Annalisa Santini

The implementation of the European Union's Directive (EU) 2021/2167 on servicers and credit purchasers (the "**SMD Directive**") confirms how central and topical the management of non-performing loans (NPLs) has become in both the national and European financial landscape.

The SMD Directive marks a pivotal step in the EU's strategy to address NPLs and foster a more integrated, efficient, and transparent secondary market for distressed credit. The SMD Directive aims to harmonise the regulatory framework for servicers and purchasers, enhance consumer and borrower protections, and facilitate cross-border transactions, thereby supporting the broader objectives of the Banking Union and Capital Markets Union.

However, as a minimum harmonisation instrument, the SMD Directive leaves significant room for national discretion. This has resulted in a patchwork of implementation approaches across Member States. What follows is an an overview of the Italian, French, German and Spanish implementation regimes.

The Italian NPL market: A mature ecosystem facing new rules

Italy's NPL market is among the most developed in Europe, with a robust ecosystem of banks, servicers and investors. The market's maturity is reflected in the sophisticated practices already in place for the servicing and sale of distressed assets. Against this backdrop, the implementation of the SMD Directive has been met with both anticipation and caution.

Market operators' perspective

Italian servicers and market operators have highlighted that the existing regulatory and operational frameworks are already well-established. The implementation of the SMD Directive regime in the Italian framework, particularly the new authorisation requirements for servicers, has prompted a careful evaluation, among the market operators, of whether to seek the new authorisation or to continue operating under existing frameworks. The decision is not merely regulatory but also strategic, as it impacts business models, client relationships, and cross-border ambitions.

Investors' perspective

For investors, the SMD Directive's push towards standardisation and transparency is largely positive. The prospect of more uniform servicing platforms and clearer rules of engagement is expected to enhance investor confidence and facilitate the entry of new players, including international funds seeking exposure to Italian NPLs.

Key features of the Italian transposition

Italy's legislative decree 116/2024, implementing the SMD Directive, introduces a comprehensive set of rules that reshape the landscape for servicers and purchasers. The main features include:

- **Scope and definitions**: the new regime applies to the purchase and servicing of "crediti in sofferenza" (non-performing loans) originated by banks and other authorised lenders. The decree provides detailed definitions of key actors;
- **Authorisation and supervision**: a central innovation is the requirement for servicers to obtain authorisation from the Bank of Italy. The Bank of Italy is empowered to supervise, inspect, and, if necessary, sanction servicers, including the power to revoke authorisations and impose operational restrictions.
- **Operational requirements and outsourcing**: servicers must operate under a written servicing agreement with the credit purchaser, ensuring compliance with all applicable laws and borrower protections. Outsourcing of servicing activities is permitted under strict conditions, with the authorised servicer retaining full responsibility for outsourced functions.

- **Handling of funds**: where servicers are authorised to receive and hold funds from borrowers, stringent safeguards apply (in respect of segregation and protection towards other creditors)
- **Borrower protection and transparency**: the decree places a strong emphasis on borrower rights. Indeed, servicers and purchasers are required to act with fairness, diligence, and transparency; the borrowers shall be individually notified of the transfer of their claims and of any subsequent changes; the communications must be clear, accurate, and non-misleading.

Cross-border activities and passporting

Italian servicers may operate in other EU Member States, and EU-authorised servicers may operate in Italy, subject to notification and compliance with local requirements. However, the regime stops short of full passporting, as host state rules and supervision continue to apply, reflecting the Directive's minimum harmonisation approach.

Comparative insights: Italy and its European peers

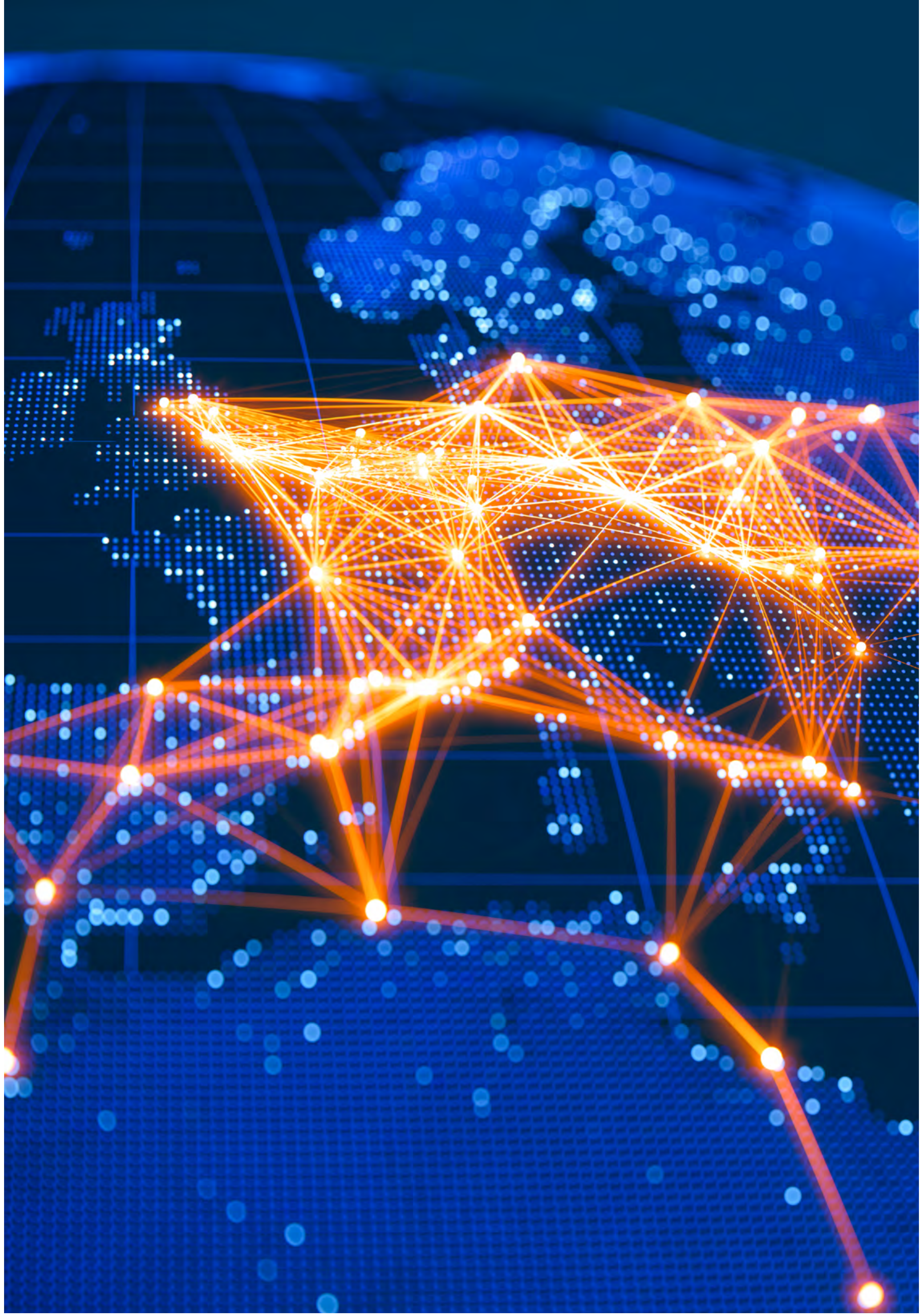
There are divergent approaches to SMD Directive implementation across Europe (and in particular, with France, Germany and Spain). While the SMD Directive's objective is to create a level playing field and facilitate a pan-European NPL market, national choices have led to a fragmented landscape.

France: early, structured, and supervisory-intensive

France stands out for its timely and structured transposition of the Directive, with new rules in force since 30 December 2023. The French Monetary and Financial Code now contains a dedicated chapter for servicers and purchasers, covering NPLs from both credit institutions and *sociétés de financement.*

Key features and peculiarities

- **Licensing and supervision**: servicers must obtain a licence from the *Autorité de contrôle prudentiel et de résolution* (the "**ACPR**"), with detailed requirements on governance, reliability, and ongoing compliance. The ACPR maintains a public register of authorised servicers and has published specific instructions and forms for licensing and reporting.



- **Borrower safeguards**: France has implemented robust conduct of business obligations, including requirements for clear, non-misleading communications, data protection, and effective complaint handling. Borrowers must be informed of loan transfers and any changes in servicing, and servicers must provide information on the amounts due and relevant legislation.
- **Handling of funds**: French servicers are permitted to receive and hold borrower funds, provided these are segregated and protected from the servicer's creditors, including in insolvency.
- **Exemptions and securitisation**: certain professionals (lawyers, notaries, judicial representatives) are exempt from the regime, and there are specific rules for securitisation vehicles and management companies of alternative investment funds.
- **Cross-border activity**: passporting is available, but subject to notification and compliance with French conduct rules. The ACPR coordinates with other EU authorities for cross-border supervision.

Germany: conservative, prudential, and risk-averse

Germany's implementation, via the *Kreditzweitmarktförderungsgesetz* (**KrZwMG**), effective from 30 December 2023, is marked by a conservative and prudential approach. The German law applies to the purchase and servicing of NPLs originated by EU credit institutions, but with a narrower perimeter than some peers.

Key features and peculiarities

- **Licensing and supervision**: servicers must be authorised by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**"), with requirements on legal form (must be a commercial partnership or legal entity with a German registered office), governance, and ongoing compliance. BaFin maintains a public register and has extensive supervisory powers, including the ability to withdraw licences for inactivity or breaches.
- **Consumer protection**: the regime mandates fair treatment, transparent communications, and effective complaint procedures. Borrowers must be informed of loan transfers and servicing changes, and servicers must maintain effective record-keeping and customer fund management.
- **Handling of funds**: servicers may hold borrower funds, subject to strict segregation and protection requirements, ensuring that borrower monies are shielded from the servicer's creditors.
- **Scope and exclusions**: the German regime is narrower in scope, excluding certain activities and professionals (lawyers, bailiffs), and does not apply to NPLs acquired before the implementation date.

- **Passporting and host state controls**: passporting is permitted, but German law retains significant host state controls, particularly regarding conduct and consumer protection. BaFin's approach is notably risk-averse, with a strong emphasis on financial stability and market integrity.

- **Alignment with Banking Law**: the regime is closely aligned with the German Banking Act, and BaFin's administrative practice is conservative, especially regarding fronting bank structures and the use of exemptions.

Spain: comprehensive, consumer-focused, and awaiting final implementation

Spain's approach to the SMD Directive is defined by a comprehensive legislative process that is still ongoing. The Draft Law on Servicers and Purchasers, expected to be enacted in 2025, will establish a dedicated regulatory regime for both the acquisition and servicing of NPLs originated by EU credit institutions and Spanish financial credit establishments (EFCs). Notably, Spain treats the purchase of credit rights and the NPL itself equivalently, extending the regime's reach.

Key features and peculiarities

- **Authorisation and supervision**: servicers will require authorisation from the Bank of Spain, with a clear licensing and registration process.

- **Consumer protection**: the Spanish regime places strong emphasis on borrower rights, mandating clear information duties, fair treatment, and free-of-charge complaint mechanisms. Servicers must provide borrowers with transparent information about loan transfers and servicing changes, and must maintain effective record-keeping and customer fund management practices.

- **Handling of funds**: Spanish servicers may be authorised to receive and hold borrower funds, provided this is expressly stated in their corporate purpose and bylaws, and subject to specific segregation requirements.

- **Passporting and cross-border activity**: the regime will allow for EU passporting, enabling authorised servicers to operate cross-border, but subject to local conduct and transparency rules. Notification to the Bank of Spain is required for appointments and changes of servicers.

- **Scope and exemptions**: the regime covers both credit rights and NPLs, and applies to loans issued by both European credit institutions and financial intermediaries. Certain professionals (notaries, lawyers, judicial representatives) and specific entities (such as the Spanish bad bank, Sareb) are exempt.

Comparative observations

Despite the harmonising intent of the SMD Directive, national regimes continue to diverge in key respects. Spain and France have adopted broad, consumer-oriented frameworks, placing particular emphasis on borrower information, complaint handling, and the protection of consumer rights. Germany, in contrast, has implemented a more prudentially-focused regime, with a narrower scope of regulated activities and a strong emphasis on financial stability and conservative licensing standards.

Italy, while closely aligned with the SMD Directive, has introduced its own distinctive features, particularly in the areas of supervision, the handling of borrower funds, and the integration of the new regime with existing banking and financial sector laws. The Italian approach sits somewhere between the consumer-focused models of Spain and France and the prudential orientation of Germany, combining robust borrower protections with detailed requirements for market participants.

All four jurisdictions – Spain, France, Germany, and Italy – formally provide for passporting and cross-border activity within the EU. However, practical barriers persist, including divergent local conduct rules, differences in the treatment of consumer loans, and varying supervisory practices. As a result, seamless market integration remains elusive, and the landscape is still characterised by national specificities in the scope of regulation, the intensity of supervision, and the operational requirements for servicers and purchasers.

In summary, while the SMD Directive has established a common baseline, significant differences remain in national implementation. Further convergence and mutual recognition of authorisations will be necessary to achieve a truly integrated European market for non-performing loans

Market impact and strategic considerations

Opportunities: the new regime offers opportunities for market consolidation, the emergence of pan-European servicing platforms, and increased investor participation. Standardised rules and enhanced transparency are expected to reduce information asymmetries and transaction costs.

Challenges: at the same time, the increased regulatory burden – particularly for smaller servicers – may raise barriers to entry and prompt market exits or consolidation. The need to adapt internal processes, governance, and IT systems to meet the new requirements is non-trivial.

Best Practices and next steps: market participants should: (a) engage proactively with the competent authorities to clarify implementation details; (b) review and update internal policies, procedures, and contracts to ensure compliance; (c) develop best practices, building on the market's existing strengths; (d) explore multi-jurisdictional coordination frameworks to facilitate cross-border operations.

Conclusion: towards a more integrated and resilient NPL market

The implementation of the SMD Directive in Italy represents a significant evolution in the regulation of the NPL market. While the new regime builds on the strengths of an already mature market, it introduces new challenges and opportunities for all stakeholders. The success of the SMD Directive's objectives – market integration, consumer protection, and financial stability – will depend on the ability of market participants, regulators, and policymakers to navigate the complexities of national implementation, foster best practices, and advocate for further convergence at the European level.

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Key considerations in 'Handover the keys' deals

By Olga Galazoula and George Bland

'Handover the keys' deals are increasingly a favoured option for private credit lenders who are faced with the need to take ownership of a business from an existing sponsor. We outline the main issues which lenders need to consider when acquiring control through a consensual restructuring.

Over the past few years, we have seen a notable increase in consensual 'handover the keys' deals, in which private equity sponsors have turned over control of overleveraged businesses to the existing senior lenders.

These deals typically involve a consensual restructuring in which the existing lenders acquire the equity for nominal consideration without the need for any enforcement or insolvency. This is often in conjunction with a debt for equity swap which puts the business on a stable basis going forward.

We outline seven of the main issues which lenders should consider when evaluating and negotiating a consensual handover.

Negotiating leverage

While sponsors are sometimes motivated to agree a consensual handover for reputational reasons, it is usually necessary to force them to the table.

Lenders should therefore consider what negotiating hooks they can use to force the sponsor's hand. For example, as part of any forbearance arrangements, it may be possible to include strict conditions as to the acceptable terms of any sale or restructuring or potentially negotiate a call option arrangement to facilitate a swift change of control.

Have a Plan B

A credible threat is often needed to force a reluctant sponsor into a consensual deal. Depending on the circumstances and the likelihood of the company cooperating, this could involve planning for a pre-packaged administration sale or using a restructuring plan to disenfranchise the sponsor.

However, a balance always needs to be struck between undertaking enough work to formulate a viable non-consensual alternative and avoiding the increased costs of parallel tracking multiple implementation routes. This can quickly become very expensive, particularly once the costs (and potential negative publicity) involved in an insolvency process are factored in.

Testing the market

Prior to agreeing a consensual handover, it will usually be necessary for the company to engage financial advisers to run an accelerated sales process. This will determine whether value breaks in the debt and may result in the sponsor becoming reluctant to complete a consensual handover if the value break is marginal and there is the possibility of equity value remaining.

Market testing will also normally be needed as part of a fallback non-consensual enforcement, so the process should be sufficiently robust in order to mitigate any potential challenge risk and avoid the need for further marketing before an insolvency practitioner is willing to agree a sale to the lender.

Buyer beware

Before taking control of a business, lenders should undertake a thorough due diligence exercise to identify any material issues with the business and any change of control consents or regulatory approvals which need to be obtained before completion.

This is particularly important given that minimal representations and warranties will be given by the outgoing sponsor (reflecting the nominal consideration they are receiving), with usually only fundamental warranties and limited business warranties being given by management.

In addition, consideration should be given to the shareholder arrangements and whether the sponsor is able to deliver a consensual sale. For example, if there are minority shareholders it may be necessary to rely on drag rights in a shareholders' agreement if the consent of those parties is unlikely to be forthcoming. Similarly, lenders will want comfort that the selling entity can complete the sale on a solvent basis and be wound up without a subsequent insolvency officeholder investigating and potentially unwinding a sale.

Structuring

Where the consensual handover also involves a debt for equity swap, comprehensive tax structuring will be key to achieving a tax efficient deleveraging. This should ensure that relevant exemptions are available where debt is being released and that the lenders do not become related parties for the purposes of corporate interest restriction rules.

Consideration should also be given to whether there are potentially valuable tax losses within the business and if so how these can be preserved and utilised.

Funding the business

When taking control of a business, it will often be necessary to inject new money in order to support an operational turnaround and pay for transaction costs. Lenders considering taking the keys should therefore ensure they have sufficient appetite to provide fresh funding and engage with management to understand the future liquidity and capital requirements of the business.

This can be particularly acute where regulatory clearances are needed, meaning that interim funding may also be required between signing and completion (with no guarantee that the deal will be approved).

Where a business has working capital facilities provided by a super senior lender, it will also be necessary to engage with them at the appropriate time in order to ensure the continued availability of these facilities and the waiver of any mandatory prepayment provisions. This is particularly important for private credit lenders who are unable to provide these types of facilities or arrange replacement ones at short notice.

Stakeholder management

When preparing to take the keys, lenders will need to manage a diverse array of stakeholders. This can include (among others) the sponsor, minority shareholders, management, other lenders, critical suppliers and regulators.

Care should be taken to involve each of these stakeholders at the appropriate time and ensure that any necessary approvals can be obtained, for example change of control consents from key counterparties and critical suppliers.

Where the sponsor has nominee directors on the boards of companies in the banking group, it will also be important to ensure that conflicts of interest are appropriately managed and that independent legal advisers are retained to advise the directors on their duties. This can also be regulated through requiring the appointment of additional independent directors or a 'chief restructuring officer' and/or having lender representatives attend board meetings as observers.

Finally, engagement with management will likely be critical for undertaking a thorough due diligence exercise and ensuring a smooth transition of ownership. Consideration should also be given to formulating an appropriate management incentive plan to retain and motivate key management.

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The growing significance of political and economic objectives in EU and UK merger control and FDI reviews

by Steven Vaz and Louisa Denison

The EU and UK authorities have recently increased their focus on considering broader political and economic policy objectives in merger control and foreign direct investment/national security reviews. These include defence, security of supply, sustainability, and the promotion of a pro-growth agenda.

Investors should take this into account when planning investments in Europe, particularly where an investment involves a strategic or sensitive sector. In particular:

- Authorities may "look-through" funds to consider the identity of their passive investors.
- Merger control reviews may no longer be confined to the impact of an investment on competition in the markets the target operates in, but also its impact on public policy and security issues, supply chain resilience, sustainability and labour markets.
- The investor's reputation and track record in operating previous investments may affect the prospect of clearance.
- Evidenced plans to achieve green benefits, promote growth and increase supply chain resilience may facilitate prompt clearances. In contrast, plans to reduce or offshore key target capabilities could raise concerns.

Broader considerations in EU merger control

Political objectives, such as security of supply, are already considered as part of the foreign direct investment (FDI) regimes that have proliferated across Europe in the last few years. By contrast, merger control reviews have primarily focused on the impact of a transaction on competition and consumers in impacted markets. The geographic location of competitors and the sustainability of their operations has been of limited relevance.

However, amidst increasing geopolitical instability, a push for decarbonisation and increased digitalisation across the economy, there has been a shift towards considering these points in the context of merger control as well.

These points are highlighted in Mario Draghi's 2024 report (prepared for the European Commission) which looks at the future of the EU's competitiveness. It addresses three key challenges that the EU faces: (1) closing the innovation gap with the United States and China, (2) creating a joint plan for decarbonisation and competitiveness, and (3) increasing security while reducing dependencies.

In May 2025 the European Commission (EC) opened a consultation on how a number of these strategic issues should be considered in merger control reviews, ahead of revising its Merger Guidelines next year. Highlights of the consultation include:

- **Sustainability and clean technology:** The transition to a clean and sustainable economy is one of the EU's key priorities. The EC is considering how the impact of a merger on sustainability can be assessed and how it can quantify and verify "green" incentives and efficiencies.
- **Security and defence:** The EC is looking at: (a) providing further guidance on the interaction between Member States' security and defence interests and the EC's competition assessment in merger control reviews, and (b) how to undertake a balancing of interests between defence and competition objectives, particularly in relation to dual-use goods. This is against the backdrop of increasing global security concerns, the war in Ukraine, and the focus on the need to adopt an EU-wide approach to defence.
- **Security of supply:** The EC is concerned about supply chain resilience, particularly in relation to security and defence, critical industries (e.g. micro-chip manufacturing), critical inputs (e.g. certain raw materials) and critical infrastructure. It considers that mergers involving companies active in these areas can increase the dependency of the industrial ecosystem in Europe on a few companies, which can expose the EU to systemic risks and supply shocks. Therefore, the EC is looking to use resilience efficiency assessments (looking at strategic resilience and resistance to external shocks) in its merger control reviews to understand how a merger may impact security of supply.
- **Media plurality:** The EC considers that a free and pluralistic media is key to holding power to account and helping citizens make informed decisions. Additionally, AI technologies have the potential to profoundly shape public discourse. Therefore, M&A in the AI and media industries has the potential to reduce the diversity of choices available to consumers. In such a landscape, a few dominant companies could wield considerable power over democratic processes by influencing public opinion. The EC is keen to consider this dynamic alongside traditional factors like price and quality when evaluating the implications of M&A in the AI and traditional media sectors.
- **Labour markets:** The EC is looking at how M&A can impede competition in labour markets by shifting the balance of power between employers and workers, which can lead to lower wages, higher unemployment, worse working conditions and lower downstream output/higher prices. While the EC already considers the potential effects of mergers on buyer power more generally, it is now looking to consider this in the context of labour markets.

Typically these points have been outside the scope of the merger control regime in the EU, and have a less direct link with competition concerns and the competitive dynamics of a particular market. Instead, they are more often considered as part of FDI assessments in Member States. However, the EC considers that competitive and contestable markets not only serve business and consumer interests, but also benefit wider societal goals, which is why it is looking at whether to reflect these points in its merger control assessments.

Enhanced EU FDI screening mechanism

The EU FDI screening mechanism sets out minimum requirements for Member States' individual FDI screening mechanisms and provides a process to coordinate Member State FDI reviews across the EU.

However, the EC's powers under the FDI screening mechanism are limited to providing comments and opinions on transactions to Member States. The Member State conducting an FDI review must take "due consideration" of the EC's view, but maintains autonomy over whether to impose remedies on (or block) a transaction.

In May 2025, the European Parliament approved draft text which would significantly strengthen the EU FDI screening mechanism. Most notably, the draft includes powers for the EC to prohibit or impose remedies on investments. This would be in circumstances where the EC and another Member State disagree with the decision of the host Member State that a particular transaction does not raise cross-border security or public order concerns.

If approved, this would provide an additional hurdle for investors for certain transactions. It would also mark a departure from the principle that national security issues are for Member States alone to decide on.

Impact of the UK's growth agenda on merger control and FDI processes

The UK Government's highest priority is to promote growth and attract investment into the UK. It released its Industrial Strategy in October 2024 which identified eight key growth-driving sectors: advanced manufacturing, creative industries, clean energy industries, defence, digital and technologies, financial services, life sciences, and professional and business services.

In turn, the UK Competition and Markets Authority (CMA) has been under pressure from the Government to ensure that the competition regime in the UK supports the growth agenda. In May 2025, the Government published its Strategic Steer to the CMA to support growth and investment into the UK. The CMA has committed itself to a 4Ps framework (pace, predictability, proportionality and process) in its merger reviews, which it recognises is a "*particularly critical area for investment, including inward investment to the UK*".

We expect the CMA to work to promote a pro-growth agenda, with a particular focus on the strategic sectors that the Government has flagged in its Industrial Strategy. For example, in 2024 the CMA cleared a telecommunications merger between Vodafone and Three (subject to remedies) despite identifying competition concerns. In its decision, the CMA found that the merger would likely result in a reduction in competition, but allowed it to proceed partly on the basis that "both companies sign binding commitments to invest billions to roll out a combined 5G network across the UK". This demonstrates a willingness by the CMA to show flexibility in its merger reviews to support innovation and investment in key UK infrastructure.

Separately from the merger control regime, the UK National Security and Investment Act (NSIA) regime has been in place since 2022. It allows the UK Government to review the national security aspects of transactions. Since the NSIA regime came into force, the Government has imposed remedies on a number of reviewed transactions to ensure that certain strategic capabilities are maintained in the UK.

As part of a review under the NSIA, the Government can take account of a proposed investor's plans post-transaction, particularly for investments in strategic assets or sectors. This can also include consideration of the investor's past behaviour with previous investments. Additionally, the Government may take a "look-through" approach when assessing potential investors and their suitability. Therefore, parties should be aware that passive investors may be considered and certain information may need to be disclosed.

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