

# WITA Academy Intensive Trade Seminar



## Oubound Investment Regulation

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# Regulating Outbound Investment

## Objectives

- **National security:** Greater consensus on addressing risks associated with investment, including investment that would support China in developing sensitive technology with military applications
- **Economic issues:** Some members of Congress also want to address economic competitiveness and supply chain issues associated with outbound investment and other commercial transactions in a broader range of sectors

## Actions

- **August 9 Executive Order** on Addressing United States Investment in Certain National Security Technologies and Products in Countries of Concern
- **Continuing legislative debate**

# Underlying US concerns

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- “We are ... looking at the impact of outbound U.S. investment flows that could circumvent the spirit of export controls or otherwise enhance the technological capacity of our competitors in ways that harm our national security.”

– National Security Advisor Jake Sullivan, July 13, 2021

- “Millions of Americans have become financial backers of the CCP without knowing it. Their savings are funding companies that build weapons for China’s People’s Liberation Army as well as companies involved in the ongoing genocide in Xinjiang. ... We are quite literally funding our own potential destruction....”

– House China Select Committee Chair Mike Gallagher, August 29, 2023

# Types of Proposals

## Notifications

Mandated reporting to allow the government to better understand investment flows and to inform future actions

## “Reverse CFIUS”

Review by an inter-agency committee with authority to mitigate or recommend that the President block transactions, potentially subject to mandatory notifications

## Prohibitions

Prohibitions on transactions in specific sectors or with named companies

# Executive Order

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- EO will lead to **prohibitions** and **notification requirements** on certain investments by US persons in China/Chinese entities involving:
  - Semiconductors
  - Quantum computing
  - Artificial intelligence
- Concurrent Advance Notice of Proposed Rulemaking (ANPRM)
- Policy focus is “intangible benefits” of US investment
  - E.g., managerial assistance, investment and talent networks, and enhanced access to additional financing
  - Not all capital

# Context: US Industrial Policy

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- Outbound EO is one part of broader Administration industrial policy
- US is developing and safeguarding key tech sectors through:
  - Major investments at home (e.g., CHIPS Act, IRA)
  - Cooperation with allies to realign global supply chains (e.g., IPEF)
  - Restrictions on sensitive technology
    - CFIUS/inbound investment screening
    - Export controls (e.g., October 7, 2022 semiconductor controls)
    - Outbound investment EO
    - Possible additional actions in other areas

# Key Issues

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- Covered/excepted transactions
- U.S. persons
- Person of country of concern/covered foreign person
- Covered technologies/products
- Timeline

# Covered Transactions

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The following (direct or indirect) transactions by a US person would be covered:

- Acquisition of an **equity** interest or contingent equity interest in a covered foreign person
- Provision of debt finance to a covered foreign person if **debt is convertible to equity**
- **Greenfield investments** that could result in establishment of a covered foreign person; and
- Establishment of a **joint venture**, wherever located, that is formed with a covered foreign person or could result in establishment of a covered foreign person



# Activities Not Covered

## Activities that would **not** be covered include

- university-to-university research collaborations
- contractual arrangements/procurement of material inputs for covered technologies or products
- intellectual property licensing arrangements
- processing, clearing, or sending of payments by a bank
- bank lending
- underwriting services
- debt rating services
- prime brokerage
- global custody
- equity research or analysis

Additional activities may be excepted, e.g., advisory services

# Excepted Transactions

- **Passive investments**

- Publicly traded securities as defined in '34 Act
- Index funds, mutual funds, ETFs, or similar instruments offered by private investment funds or investment companies

- **Passive limited partner investments**

- Passive; no influence; only vote shares
- No board member or observer on board of covered foreign person
- **Below *de minimis* threshold** (metric subject to debate: amount of investment/AUM/percentage of fund's total capital)

- **Intracompany transfers**

- **Binding commitments**

- **Buyout** of Chinese shares in third country

# US Person

- US citizens and lawful permanent residents
- Entities organized under the laws of the US or any US jurisdiction, including their foreign branches
- Any person in the US

# Expanded/Extraterritorial Application

- **Indirect investments** in a third country entity that will use funds for prohibited investment in China – *closing loophole*
- **Foreign subsidiaries** of US entities not covered directly, but...
  - US person must take “**all reasonable steps**” for foreign person it controls (50% direct or indirect interest) to prohibit or prevent transaction that would be prohibited for a US person
  - US person must notify Treasury of any transaction by a foreign person it controls that would require notification if made by a US person
- US person (e.g., U.S. officer or director) **knowingly directing** foreign entity transaction that would be prohibited if made by a US person, including:
  - Foreign fund investments
  - Foreign corporate M&A/investments
- Establishment of **JVs, wherever located**, that include a US person



**WITA**

Washington International Trade Association

# Application to Funds

- Treasury intends to cover investments by foreign funds managed by **US person general partners**
- ANPRM includes 3 investment fund scenarios that Treasury intends to cover:
  - (i) a US person general partner manages a foreign fund that undertakes a transaction that would be prohibited if performed by a US person
  - (ii) a US person is an officer, senior manager, or equivalent senior-level employee at a foreign fund that undertakes a transaction at US person's direction when transaction would be prohibited if performed by a US person
  - (iii) several US person venture partners launch non-US fund focused on undertaking transactions that would be prohibited if performed by a U.S. person
- US managed fund may have to take “reasonable steps”
- As noted, some US limited partner investments expected to be covered (e.g., above *de minimis*)

# Person of “Country of Concern”

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1. Citizens and permanent residents of China who are not US persons
2. Entities organized or with principal place of business in China
3. Chinese government and persons controlled by or acting on behalf of the government
4. Entities owned by any of 1 – 3 above
  - Owned is likely to mean 50% or greater, i.e., **Chinese subsidiaries**

# Covered foreign person

1. Any person of a country of concern (China) that is engaged in, or that a US person **knows or should know** will be engaged in, a covered activity with respect to a covered technology or product
2. A person whose direct or indirect subsidiaries/branches
  - are referenced above, and
  - individually or in aggregate, comprise >50% of that person's consolidated revenue, net income, capital expenditure, or operating expenses
    - *Applies to parents inside and outside China*
    - *Relation to separate coverage of "indirect" transactions?*

**Knowledge standard:** "actual or constructive," including awareness of high probability of future activities, based on "reasonable due diligence"

# Covered Technologies and Products



<u>Technologies</u>	<u>Prohibited</u> <i>Covered transactions with covered foreign persons engaged in activities involving:</i>	<u>Notification Requirement</u> <i>Covered transactions with covered foreign persons engaged in activities involving:</i>
<i>Semiconductors and Microelectronics</i>	<ul style="list-style-type: none"> <li>• Development of electronic design automation software or semiconductor manufacturing equipment</li> <li>• Design, fabrication, or packaging of advanced integrated circuits</li> <li>• Installation or sale of supercomputers</li> </ul>	<ul style="list-style-type: none"> <li>• Design, fabrication, and packaging of other (less advanced) chips</li> </ul>
<i>Quantum Computing</i>	<ul style="list-style-type: none"> <li>• Production of quantum computers and certain components</li> <li>• Development of quantum sensing platform designed exclusively for military, intelligence, or mass-surveillance end uses</li> <li>• Development of quantum networking and communication systems designed exclusively for secure communication</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>
<i>Artificial Intelligence</i>	<ul style="list-style-type: none"> <li>• Development of software that incorporates an AI system and is designed exclusively/primarily for military, intelligence, or mass-surveillance end uses</li> </ul>	Exclusively/primarily designed for: <ul style="list-style-type: none"> <li>• cybersecurity applications</li> <li>• digital forensics tools</li> <li>• penetration testing tools</li> <li>• control of robotic systems</li> <li>• certain surreptitious listening devices</li> <li>• non-cooperative location tracking</li> <li>• facial recognition</li> </ul>



# Rulemaking process

- ANPRM comments due last Thursday, September 28
  - Treasury set forth 83 specific questions in the ANPRM, including on anticipated costs and burdens of compliance
  - 60 comments received
- Expected process



- New regime not expected to be operational until mid-2024 at earliest

# Other Key Points

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- **Annual review**, which could result in modification or expansion
- **Penalties** up to **\$356,579**
- Engagement with **foreign governments**

# Congressional Reaction and Possible Actions

- Hill reactions to EO
  - House Financial Services Committee Chair Patrick McHenry applauded EO as “a more thoughtful and targeted approach than initially reported”
  - House China Select Committee Chair Mike Gallagher said EO “loopholes are wide enough to sail the PLA Navy fleet through”
- Possible outbound investment legislation
  - Outbound Investment Transparency Act in Senate NDAA bill (Casey/Cornyn)
  - Chinese Military and Surveillance Company Sanctions Act of 2023 (Barr)

# Questions?



## Thank you!