

Finally, An Update on Outbound Investment

JUNE 26, 2024

Key Takeaways

- Almost a year after President Biden signed an Executive Order to establish a U.S. outbound investment regime, the U.S. Department of the Treasury has published a [Notice of Proposed Rulemaking](#) (“NPRM”) on U.S. outbound investment. The NPRM contains the full proposed rule for implementing the Executive Order.
- The U.S. outbound investment program is intended to be “narrow and targeted” but will apply to all U.S. persons and cover a broad range of conduct from capital contributions to intangible benefits provided to advanced technology sectors in “countries of concern” (which currently only includes the People’s Republic of China, the Special Administrative Region of Hong Kong, and the Special Administrative Region of Macau). Importantly, the proposed rule does not prohibit all investments in a country of concern.
- The investment community should monitor the development of this program and evaluate its impact on their business.

This OnPoint analyzes the new version of the proposed rule for the U.S. outbound investment regime.

U.S. Outbound Investment Program Overview

Background

The U.S. Government currently reviews inbound foreign investments in, and acquisitions of, U.S. businesses to determine the impact on U.S. national security via the U.S. Committee on Foreign Investment in the United States (“CFIUS”), which has the authority to impose mitigation measures, suspend transactions, and, where appropriate, recommend that the President block or unwind transactions.

However, the Biden Administration generally describes U.S. outbound investments as also being particularly valuable to persons from countries of concern because they often include the transfer of “intangible benefits” in addition to capital. Such intangible benefits include enhanced standing, managerial assistance, access to investment and talent networks, access to markets, and access to additional financing.

Accordingly, on August 9, 2023, President Biden signed a highly anticipated [Executive Order](#) to establish a U.S. outbound investment regime. The U.S. Department of the Treasury (“Treasury”) concurrently published an [Advance Notice of Proposed Rulemaking](#) (the “ANPRM”) to initiate a rulemaking process to develop and implement an outbound investment regime that addresses the national security threat posed by “countries of concern” seeking to exploit advanced technologies and products to enhance their military, intelligence, surveillance, or cyber-enabled capabilities (the “U.S. Outbound Investment Program”). The ANPRM invited public comments on the intended outbound investment regulations, which were due by September 28, 2023. Likewise, the NPRM also invites public comments, which will be due by August 4, 2024.

Currently, the primary motivating concern is the desire to prevent capital flows, technical know-how, and other intangible benefits into sectors of the Chinese economy that support the Chinese Government's "military-civil fusion" regime, which seeks to develop the most technologically advanced military by removing barriers between civilian and defense sectors. Although other countries (including China, Taiwan, and South Korea) already employ some form of an outbound investment regime, the U.S. Outbound Investment Program will be the first of its kind in a major Western economy.

Form & Scope

Contrary to expectations, the U.S. Outbound Investment Program is not a "reverse CFIUS" process. Although certain covered transactions will require notification to Treasury, there will be no review and approval mechanism akin to CFIUS or affirmative approval required for outbound investment transactions of concern. In brief, the U.S. Outbound Investment Program will include prohibitions and notification obligations for U.S. persons.

- **Prohibitions.** U.S. persons will be prohibited from engaging in certain outbound investment transactions involving (i) entities located in or subject to the jurisdiction of a country of concern or entities owned by persons of a country of concern, and (ii) technologies and products that pose a particularly acute threat to U.S. national security.
- **Notification Obligations.** U.S. persons will be required to notify Treasury of certain other outbound investment transactions involving (i) entities located in or subject to the jurisdiction of a country of concern or entities owned by persons of a country of concern, and (ii) technologies and products that may contribute to a threat to U.S. national security.

Although the NPRM provides that Treasury may request information about transactions by U.S. persons that are or will be completed or agreed to after August 9, 2023 (i.e., the date of issuance of the Executive Order), there will be no formal, retroactive look-back period for covered transactions completed before the implementing regulations are promulgated.

The U.S. Outbound Investment Program is not intended to broadly impede U.S. investment in a country of concern or impose sector-wide restrictions on certain U.S. outbound investment activity. Rather, the proposed scope of the U.S. Outbound Investment Program is intended to be narrowly tailored to restrict and monitor U.S. investment (and related capital flows) into specific areas of advanced technologies and products that countries of concern can use to undermine U.S. national security.

Accordingly, the proposed scope of the U.S. Outbound Investment Program is focused on participation by "U.S. persons" in "covered transactions" that could aid in the advancement of three types of advanced technologies and products that pose a risk to U.S. national security ("national security technologies and products"):

- Semiconductors and microelectronics;
- Quantum information technologies; and
- AI systems with specific end uses.

Definition of U.S. Person

The proposed rule defines "U.S. person" as any U.S. citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction within the United States, including any foreign branches of any such entity, and any person in the United States. The implementing regulations will apply to U.S. persons wherever they are located. Interestingly, the definition of U.S. person does not extend to non-U.S. subsidiaries, but the NPRM's proposed requirement that a U.S. person "take all

reasonable steps to prohibit and prevent any transaction by a foreign entity controlled by such United States person that would be a prohibited transaction if engaged by a United States person” creates an obligation for U.S. parents that control non-U.S. entities (as discussed in more detail below).

Definition of Covered Transaction

A “covered transaction” is defined to include:

- Acquisitions of equity interests or contingent equity interests (such as options-like investments) in a covered foreign person;
- Provision of debt financing to a covered foreign person where such debt financing is convertible to an equity interest;
- Greenfield investment that could result in the establishment of a covered foreign person; or
- The establishment of a joint venture, wherever located, that is formed with a covered foreign person or could result in the establishment of a covered foreign person.

The definition of covered transaction will also include indirect transactions via intermediary entities.

However, the definition of “covered transaction” will not include certain categories of activities such as university to university research collaborations, intellectual property licensing arrangements, bank lending and payment services, and underwriting services. Certain passive investments (such as passive investments in publicly traded securities and investment funds), equity interest buyouts, intercompany transfers, and transactions involving committed but uncalled capital, also will be exempted from the definition of covered transaction.

Definition of Covered Foreign Persons

“Covered foreign person” is defined to include:

- A person of a country of concern that is engaged in, or a person of a country of concern that a U.S. person knows or should know will be engaged in, an identified activity with respect to a covered national security technology or product; or
- A person whose direct or indirect subsidiaries or branches are engaged in the above and which, individually or in the aggregate, comprise more than 50 percent of that person’s consolidated revenue, net income, capital expenditure, or operating expenses.

The “knowledge” standard will include actual or constructive knowledge as well as “reason to know” or “reason to believe” (similar to the definition of knowledge in the Export Administration Regulations). Treasury also will restrict U.S. persons from “knowingly directing transactions” covered by the implementing regulations. “Directing” will include ordering, deciding, approving, or otherwise causing to be performed a transaction prohibited under the implementing regulations if engaged in by a U.S. person.

The NPRM: What to Know

1. *The U.S. Outbound Investment Program imposes a wide net of obligations.*

Under the U.S. Outbound Investment Program, U.S. persons carry the responsibility to notify or prohibit and prevent a “covered transaction,” which is defined to include indirect transactions via intermediary entities. For example, a U.S. “parent” entity of a non-U.S. subsidiary cannot direct its non-U.S. subsidiary (or its “controlled foreign entity”) to engage in a covered transaction that is prohibited under the U.S. Outbound Investment Program; to the contrary, it must ensure that the investment does not occur.

The NPRM defines “parent” as a person who (i) directly or indirectly holds more than 50% outstanding voting interest in, or voting power of the board of, an entity, (ii) a general partner, managing member, or equivalent of an entity, or (iii) the investment adviser to an entity that is a pooled investment fund (citing to the Investment Advisers Act of 1940 for what constitutes an “investment advisor”). Note that indirect and direct interests should be considered in the aggregate to determine whether the voting percentage threshold is met.

The NPRM also outlines the factors that Treasury will consider in determining whether a U.S. person “took all reasonable steps” to prohibit and prevent a covered transaction. Such factors include:

- The execution of agreements with respect to compliance with the U.S. Outbound Investment Program between the U.S. parent and the controlled foreign entity;
- The existence and exercise of governance or shareholder rights by the U.S. parent with respect to the controlled foreign entity, where applicable;
- The existence and implementation of periodic training and internal reporting requirements by the U.S. parent and its controlled foreign entity with respect to compliance with the U.S. Outbound Investment Program;
- The implementation of appropriate and documented internal controls, including internal policies, procedures, or guidelines that are periodically reviewed internally, by the U.S. parent and its controlled foreign entity; and
- The implementation of a documented testing and/or auditing process of the aforementioned internal compliance policies, procedures, or guidelines.

Investors must be aware of their investments – both direct and indirect – and ensure they are monitoring for any potential prohibited or notifiable transactions to prevent any unintended consequences. Likewise, investors need to effectuate their own compliance controls both at the investor and target level to ensure compliance with the U.S. Outbound Investment Program to also prevent unintended violations.

2. The scope of “excepted transactions” is more clearly defined than before.

The NPRM is responsive to commenters’ requests that Treasury make clear any transactions that constitute “excepted transactions” under the U.S. Outbound Investment Program that would otherwise be subject to prohibition or notification by a U.S. person. Although the enumerated exceptions may change, the NPRM states that so long as a U.S. person is not afforded certain rights which are not standard minority shareholder protections in a given circumstance, the following transactions will be excepted:

- Investments in a publicly traded security (as security is defined in the Securities Exchange Act of 1934) that trades on a non-U.S. or U.S. securities exchange or “over-the-counter;”
- Investments in securities issued by an “investment company” (as defined in the Investment Company Act of 1940 (the “ICA”)) that is registered with the U.S. Securities and Exchange Commission (i.e., index funds, mutual funds, exchange traded funds) and business development companies under the ICA;

- Investments made as a limited partner (“LP”) or equivalent in venture capital funds, private equity funds, funds of funds, or other pooled investments depending on the size and characteristics of the investment;
- A full buyout of equity or other interests held by a person of a country of concern, such that the entity is no longer a covered foreign person;
- Transactions between a U.S. “parent” and such parent’s controlled foreign entity in support of ongoing operations that are not covered by the U.S. Outbound Investment Program (i.e., covered activity or engagement in a covered transaction);
- Transactions entered into before August 9, 2023, including the fulfillment of uncalled capital commitments entered into before such issuance;
- Lending transactions involving banks in which the U.S. lender in a syndicate acquires a voting interest in a covered foreign person in an event of default and such lender does not have the ability to initiate an action and does not have a lead role in the syndicate. Note that the syndicate is stated to comprise banks and “banks” is not defined anywhere. Thus, it is unclear whether syndicates with non-banks (e.g., funds) will be included in this exception; and
- Transactions involving non-U.S. persons may be excepted if the Treasury Secretary determines that the country from which such non-U.S. person hails is also addressing national security concerns arising from outbound investments within that country’s jurisdiction. This particular exception is new to the proposed rule and may signal that U.S. allies will debut their own outbound review programs in the future.

Notably, Treasury declined to provide a de minimis threshold below which a person of a country of concern’s activity involving national security technologies or products will not trigger covered activity.

3. Treasury is seeking input on the scope of the LP exception.

Although the LP exception is of key importance for dealmakers, there are limitations. For example, an LP investment into a pooled fund that a U.S. person knows will likely be invested in a person from a country of concern that is engaged in one or more of the “covered national security technologies and products” described in the NPRM (e.g., semiconductors and microelectronics, quantum information technologies, and AI systems with specific end uses) is a covered transaction.

Treasury is also seeking further input on the full scope of the exception. The NPRM outlines two proposals to determine whether an LP investment qualifies for an exception from the U.S. Outbound Investment Program’s jurisdiction. The two proposals are similar in that both exclude LP investments that afford LPs certain rights that are not standard minority shareholder protections, such as the right to:

- Approve, disapprove, or otherwise influence or participate in the investment decisions of the fund;
- Approve, disapprove, or otherwise influence or participate in the decisions made by the general partner, managing member, or equivalent related to entities in which the fund is invested; and/or
- Unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent of the fund.

The two proposals differ, however, in their approach to assessing the importance of the LP to the fund in which the LP is making its investment. Specifically, proposal one provides that the LP’s committed capital cannot be more than 50% of the total assets under management, while proposal two provides that the LP’s committed capital cannot be more than \$1 million, aggregated across any investment and co-investment vehicles that comprise the fund.

Investors are encouraged to submit comments to Treasury to inform the final version of the LP investment exception.

4. Treasury will consider certain factors to determine whether a U.S. person meets the knowledge standard.

Multiple commenters stated that it would be difficult to determine when a U.S. person should “know” that a transaction is a covered transaction. In response, the NPRM presents multiple factors for Treasury to consider in assessing whether a U.S. person had knowledge that an investment would result in a prohibition or a notification to the U.S. Government. Such factors include:

- The U.S. person’s inquiry into the investment target or relevant counterparty of nonpublic information (including diligence questions asked at the time of the transaction);
- Use of public information to identify and verify information regarding counterparties; and
- Representations and warranties in transaction documents that were obtained or attempted to be obtained from counterparties.

The factors demonstrate that the U.S. Outbound Investment Program’s requirements are expected to be reflected through pre-transaction diligence and transactions’ contractual arrangements.

Additionally, Treasury rejected the request that it maintain a public list of covered foreign persons. Thus, the onus remains with investors and dealmakers to ensure they are conducting adequate diligence and thereby ensuring that they (and their controlled entities) are not engaging in covered transactions that are prohibited or that require notification to the U.S. Government.

What’s Next

As described above, the comment period deadline for the NPRM is August 4, 2024, and Treasury will need time to consider comments before promulgating the final rule. Investors should consider whether there are specific issues applicable to their U.S. outbound investment strategy and whether engaging with Treasury as part of the NPRM process is worthwhile. Given the magnitude of the program, we continue to expect significant interest and commentary from U.S. and non-U.S. persons alike. Although the timing of the final rule is not yet known, the NPRM signals that Treasury is actively engaging on establishing the U.S. Outbound Investment Program and investors should remain alert.

Investors must also stay aware of corresponding moves by U.S. allies. The Biden Administration continues to work with allied countries (including G7 members and others) to encourage the development of parallel outbound investment restrictions. As mentioned above, the definition for “excepted transactions” now includes certain transactions involving persons of third countries and likely signals the U.S. Government’s expectation that other outbound investment programs will be established by allied countries. Although there have not yet been any similar announcements made by U.S. allies to establish complementary outbound investment programs, it is widely reported that both the European Union and the United Kingdom are considering the development of parallel regimes.

However, if similar outbound investment programs are not established by U.S. allies, the Biden Administration will need to consider whether the U.S. Outbound Investment Program will put U.S. investors at a competitive disadvantage in the global market, and whether the impact of the regime is worth the cost to the U.S. economy. It will remain important to monitor if the timing of formal implementation of the U.S. Outbound Investment Program is delayed to provide additional time for coordination among the United States and its allies.

We will continue to monitor the U.S. Outbound Investment Program’s development and keep investors apprised of important news.

Related Professionals



PARTNER

Jeremy B. Zucker

Washington, D.C.
+1 202 261 3322



PARTNER

Darshak S. Dholakia

Washington, D.C.
+1 202 261 3467



PARTNER

Hrishikesh N. Hari

Washington, D.C.
+1 202 261 3347



ASSOCIATE

Brooklynn Moore

Washington, D.C.
+1 202 261 7920



ASSOCIATE

Amy A. Jicha

Charlotte
+1 704 339 3128



ASSOCIATE

Betsy Feuerstein

Washington, D.C.
+1 202 261 3366

Related Services

National Security