



The US Outbound Foreign Investment Regime Takes Shape: Key Takeaways from the Draft Regulations

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After ten months, the US Department of the Treasury has released further details on its proposed outbound foreign investment regime. The release of the [Notice of Proposed Rulemaking \(NPRM\)](#) on June 21 gives the latest view into which investments into China may be prohibited or notifiable under the proposed regulations.

The draft regulations are still not fully baked, and a final rule is not likely to take effect for some time. The NPRM includes 25 specific questions for which Treasury is still seeking public input. Public comments on the NPRM will be accepted until August 4, 2024, after which Treasury and other US government agencies participating in the regulatory process will consider the responses to the questions and any other comments, make whatever changes to the draft rules they deem advisable, and publish a final rule. It is unlikely that the final rule will take effect immediately upon publication; except in some situations, new regulations usually take effect at least 30 days after publication, giving the private sector and relevant government agencies additional time to prepare.

In [our August 2023 blog post](#), we identified a number of key questions concerning the regime as well as a number of open issues. We recap below the developments in outbound investment so far, and highlight both what we've learned from the NPRM and what key issues remain unresolved.

Developments so far

President Biden created a framework for outbound foreign investment restrictions under [Executive Order 14105](#), issued August 9, 2023, targeting certain Chinese technology companies. The new regime will require notification for some transactions (notifiable transactions) either before or within 30 days after closing, while prohibiting other transactions outright (prohibited transactions).

Immediately following issuance of the executive order, the US Department of the Treasury released an [Advance Notice of Proposed Rulemaking \(ANPRM\)](#) seeking public inputs on 83 different subjects relating to the types of investors, technologies, and transactions that will be within the scope of both notifiable and prohibited transactions. The period for collecting public inputs responding to the ANPRM ended in September 2023, and on June 21, 2024, Treasury released the lengthy NPRM containing draft regulations implementing the new regime. The regime can affect transactions where neither party is based in the United States, so non-US strategic and financial investors in relevant activities should consider how the regime could affect them as well.

What business activities are covered?

The NPRM uses a more specific "covered activities" approach rather a potentially unwieldy sectoral approach, though the activities are described by the three sectors previously identified in Executive Order 14105 and the ANPRM:

- Semiconductors and microelectronics. The NPRM covers the design, fabrication, and packaging of integrated circuits, requiring notification generally and prohibiting certain activities related to mass manufacture of integrated circuits and high-end or supercomputing applications. In particular, prohibited transactions concern the development or production of any electronic design automation software for the design of integrated circuits or advanced packaging; front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits; equipment for performing volume advanced packaging; design or fabrication of any integrated circuit meeting specified technical criteria; using advanced techniques for packaging integrated circuits; and developing, producing, selling, or installing a supercomputer meeting specified technical criteria. Notifiable transactions include design, fabrication, or packaging of any integrated circuits not covered under the prohibited transaction rule.
- Quantum information technologies. There are no notifiable transactions relating to quantum technologies. Prohibited transactions concern the development of quantum computers or production of critical components of quantum computers; development or production of quantum sensing platforms that are intended for use by military, government intelligence, or mass surveillance end uses; and development or production of quantum network or communications systems intended for use in networking quantum computers to increase their capabilities (such as for decryption); secure communications; or any other application with a military, government intelligence, or mass surveillance end use.
- Artificial intelligence (AI) systems. The NPRM primarily covers transactions relating to AI systems with military, government intelligence, or mass surveillance end uses, distinguishing them from AI systems used for purely commercial purposes. Prohibited transactions relate to AI systems exclusively used or intended for such uses, as well as AI systems trained using a specified threshold of computational operations. Notifiable transactions concern other AI systems designed for military, government intelligence, or mass surveillance end uses or for cybersecurity applications, digital forensics tools, penetration testing tools, or control of robotic systems, as well as AI systems trained below the computational operations threshold for prohibited transactions. Notably, Treasury is considering three different thresholds of computational operations for distinguishing between prohibited and notifiable transactions, and has asked for public input to help reach a decision.

What investment targets are covered?

Executive Order 14015 and the NPRM are concerned with investments enabling these activities by “countries of concern.” That term has different meanings in various contexts, but for purposes of the outbound foreign investment regime, the only country of concern is China, including its special administrative regions of Hong Kong and Macau.

The NPRM applies to “persons of countries of concern,” defined as:

- any Chinese citizen who is not also a US citizen or a US permanent resident;
- any entity with its legal domicile, principal place of business, or headquarters in China;
- any Chinese government entity (including the government of any political subdivision);
- any entity in which the Chinese government (including the government of any political subdivision), individually or in the aggregate, holds a 50% or greater voting or equity interest or can otherwise direct or cause the direction of the management or policies of the entity;
- any entity in which one of the previously described individuals or entities (individually or in the aggregate) holds a 50% or greater voting or equity interest; or
- any entity in which one or more entities described in the previous bullet, individually or in the aggregate, holds a 50% or greater voting or equity interest.

The application of the NPRM to any entity in which the Chinese government can direct or cause the direction of the management or policies of the entity could be very broad. We know that the Committee on Foreign Investment in the United States (CFIUS), led by the same Office of Investment Security responsible for implementing the outbound foreign investment regime, has largely stopped distinguishing between its treatment of state-owned and private-sector Chinese companies because of the degree of influence the government in Beijing can exert (and has exerted) on private enterprises. A similar approach in implementing the NPRM would broaden its scope significantly.

The NPRM also applies to any individual or entity (including non-Chinese individuals or entities) who holds a voting interest, board seat, or equity interest in any of the entities described above and also satisfies any of the following criteria, based on the most recent annual financial statement:

- Derives at least 50% of its revenue or net income from one or more of the entities described above,
- Makes 50% or more of its capital expenditures through one or more of the entities described above, or
- Incurs 50% or more of its operating expenses from one or more of the entities described above.

This provision could theoretically affect investments in various businesses outside China. For example, a US company that designs semiconductors in the United States but spends more money producing or selling them through a joint venture in China could fall within the scope of the NPRM. One issue for which Treasury has specifically requested public comment is how best to handle situations like these when an US person could also be a person of a country of concern.

Finally, in an effort to coordinate the outbound foreign investment regime with other restrictions on US dealings with China, the NPRM also prohibits any covered activities (whether they are listed as prohibited or notifiable) with entities named:

- On the Entity List or Military End-User List or as Military Intelligence End Users by the Bureau of Industry and Security (BIS) of the US Department of Commerce;
- On the Specially Designated Nationals and Blocked Persons (SDN List) of the US Department of the Treasury, including any entity in which one or more individuals or entities on the SDN List holds (individually or in the aggregate) a 50% or greater interest;
- On Treasury's Non-SDN Chinese Military-Industrial Complex Companies List; or
- As foreign terrorist organizations by the US Department of State.

Which investors are covered?

The outbound foreign investment regime will directly apply to US citizens and permanent residents, as well as US-domiciled entities and their non-US branches, and "any person in the United States." This last provision is intended to capture individuals who are not US citizens or permanent residents but whose presence in the United States (e.g., pursuant to work or student visas) could allow them to accrue knowledge that could further Chinese capabilities in the three covered sectors.

There are also indirect investors who could be covered due to the involvement of a US person. "Controlled foreign entities" are non-US entities in which a US person is a majority owner of voting interests, a general partner or equivalent, or investment adviser to a pooled investment fund. That US person is obligated to take any reasonable steps that would prevent a transaction by the US person's controlled foreign entity that would be a prohibited transaction if undertaken directly by a US person or to submit a notification for any notifiable transaction.

US persons are also prohibited from “knowingly directing” a transaction by a non-US person that would be a prohibited transaction if undertaken by a US person, and are required to submit a notification for any notifiable transaction knowingly directed by the US person. The definition of “knowingly directing” is critical for US persons who work with non-US entities and need to know the scope of this provision.

- “Knowledge” is defined in the NPRM as actual knowledge of a fact or circumstance, awareness of a high probability that a fact or circumstance exists or will occur, or reason to know of a fact or circumstance’s existence. The NPRM separately notes that lack of knowledge will not be excused if the US person failed to conduct a reasonable and diligent inquiry as to whether a transaction was notifiable or prohibited and outlines specific factors that would qualify the US person’s inquiry as “reasonable and diligent.”
- “Directing” has a broader definition under the NPRM than in general use. A person is deemed to be able to “direct” a transaction if the person has authority, individually or as part of a group, to make or substantially participate in decisions on behalf of a non-US person. The explanatory preamble to the NPRM includes an example in which a senior executive routinely participates in a non-US company’s strategic investment decisions, and reviews and votes in favor of an quantum computing investment that would have been a prohibited transaction. The US person’s one vote (among an unspecified number of votes) would be deemed to be “knowingly directing” the transaction. The NPRM also includes a carve-out provision that would avoid liability for the US person under this scenario if the executive had been recused from considering the investment.

The NPRM’s explanatory note states that the purpose of this provision is not to limit employment of US persons by non-US companies—it is only aimed at capturing involvement by key personnel in decisions involving potentially covered transactions.

What types of transactions are covered?

In addition to direct equity investments in relevant target businesses, the scope of the reporting requirements and prohibitions extend to the following additional transaction types:

- Acquisitions of contingent equity interests;
- The subsequent conversion of the contingent interest into equity (i.e., if the transaction is notifiable, a notification may have to be submitted for the acquisition of the contingent interest and then again upon conversion);
- Issuance of debt if both (i) the debt is secured by an equity interest and (ii) the debt covenants afford the US creditor the right to appoint board members or make management decisions on behalf of the target;
- “Greenfield” and “brownfield” transactions in which the US person acquires, leases, or develops operations, land, property, or other assets in China that the investor knows (or intends) will result in the creation of a covered target business or a person of a country of concern engaging in a covered activity in which the person was not previously engaged;
- Entering into a joint venture with a person of a country of concern when the US person knows or intends that the joint venture will enter into a covered activity; and
- Investing in a limited partnership, venture capital fund, private equity fund, fund of funds, or other pooled investment vehicle if the US person knows the fund is investing in a covered activity and that investment would be a covered investment if undertaken directly by a US person.

Will there be any exceptions?

The NPRM proposes a number of exceptions, though some of the Treasury Department’s requests for additional public inputs concern the scope of these exceptions:

- Passive investments in any securities that are traded publicly on any securities exchange or “over-the-counter” market anywhere in the world;
- Passive investments in any “investment company” registered with the US Securities and Exchange Commission, including mutual funds, index funds, or exchange traded funds, or any company that has elected to be a “business development company” under the Investment Company Act of 1940;
- Investing as a limited partner or equivalent in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund (other than those described in the preceding bullet), provided that—subject to public inputs that will inform Treasury’s choice—either (i) the investment carries no material governance rights with respect to the fund or its covered portfolio holdings or (ii) the capital commitment of the US person to the fund (aggregated across all investment and co-investment vehicles) is no more than US\$1 million;
- Conversion of debt into equity upon default, provided that the US person is part of a syndicate of lenders but does not have a lead role in the syndicate or the independent authority to initiate any action with respect to the debtor;
- The full buyout by a US person of all interests held by persons from a country of concern so that the target no longer qualifies as a covered foreign person;
- An investment by a US parent in its controlled subsidiary to support ongoing operations or non-covered activities, provided that the investment does not qualify as a greenfield or brownfield investment as described above or establishment of a covered joint venture;
- An investment to which the US person was committed prior to the issuance of Executive Order 14105 on August 9, 2023; and
- Investments with or via non-US entities from countries that either have their own national security-based controls on outbound foreign investment or otherwise address concerns with such investments adequately, as determined by the Secretary of the Treasury after consultation with other US government agencies. This provision echoes CFIUS’s standards for identifying “excepted foreign states” in which qualifying investors are exempt from CFIUS jurisdictional and mandatory filings rules established since 2018.

The NPRM contemplates another exception for transactions deemed by the Secretary of the Treasury to be in the national interest following an application by the US person making the investment. Treasury has also asked for public input on this proposal; it is not clear how an application can be submitted without notifying Treasury of the transaction, implying that the exception would only have a meaningful effect if the applicants were hoping to receive Treasury clearance for investments that would otherwise be prohibited transactions. This would place Treasury in the role of reviewing the merits of specific transactions—something the regime was not intended to do (despite being referred to colloquially as “reverse CFIUS”). Furthermore, using “national interest” as the standard for granting an exception would place Treasury in the unusual position of assessing the potential benefits of a transaction, which is arguably a more difficult challenge than the current practice (at CFIUS) of identifying risks transactions may pose to US national security.

Penalties for non-compliance

Once the new regulations take effect, violations of the notification and prohibition requirements will carry potential civil and criminal penalties under the International Economic Emergency Powers Act. In addition, the accuracy of notifications must be certified by an authorized person, and if the certification proves false, the individual making the certification could be subject to criminal penalties for making a false statement in a government proceeding.

If the transaction was a prohibited transaction, it can be voided if still pending, or the acquirer can be forced to divest its interest if the transaction was already completed.

Also, a US person who learns after the fact about a transaction that should have been notified or prohibited must notify the Treasury Department within 30 days. This disclosure does not preclude liability for failure to notify or prevent the transaction, but a voluntary self-disclosure may mitigate sanctions imposed by Treasury.

What open issues remain, and how can interested parties comment on the NPRM?

The NPRM includes 25 questions for which Treasury is seeking public inputs. Some of the issues are discussed above, but the first question is fairly existential:

"Are there areas where the proposed rule is broader than necessary to address the national security concerns identified in the Outbound Order? Are there areas where it is narrower than necessary or contains loopholes? If so, where and what adjustments should be made?"

When considered along with the more specific questions asked by Treasury in the NPRM, this question suggests that there is still considerable work to be done before a final rule is issued.

Public comments on the NPRM will be accepted until Sunday, August 4, 2024. Once the NPRM has been published in the Federal Register, comments can be submitted electronically at <https://www.regulations.gov/> or by mail to the Treasury Department address specified in the NPRM.