

White House Issues Outbound Investment Executive Order and Treasury Department Solicits Comments on This New Regulatory Program: 5 Key Takeaways

After publicly signaling support for an outbound investment screening mechanism in July 2022, the Biden Administration has issued a long-anticipated Executive Order to address certain investments by US persons in “countries of concern.”

On August 9, 2023, President Biden [issued](#) an Executive Order Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern (the EO). The stated objective of the EO, which was issued under the International Emergency Economic Powers Act ([50 U.S.C. 1701 et seq.](#)) (IEEPA), is to address the national security threat posed by the advancement by countries of concern in sensitive technologies and products critical for the military, intelligence, surveillance, or cyber-enabled capabilities of such countries and to restrict certain US investments that may exacerbate this threat. The People’s Republic of China, together with the Special Administrative Regions of Hong Kong and Macau, is the only “country of concern” currently listed in the Annex to the EO.

The EO differs in key ways from earlier legislative proposals, which we discussed in our [Client Alert](#) from July 2022. Notably, the EO does not establish a case-by-case review of outbound investments. Instead, it directs the Department of the Treasury (Treasury) to issue regulations prohibiting certain transactions by United States Persons (US persons) and requiring notification of other transactions by US persons. Treasury has not yet issued proposed regulations, which are not expected to take effect until the second half of 2024 or later.

Concurrent with the EO, Treasury [issued](#) an Advance Notice of Proposed Rulemaking (ANPRM) to solicit comments on the scope of the new program, and is seeking input from the public by September 28, 2023. Treasury also issued an accompanying [fact sheet](#) about the EO and the ANPRM.

The EO and the ANPRM reflect concepts from both foreign investment reviews by the Committee on Foreign Investment in the United States (CFIUS) and US economic and trade sanctions administered by the Office of Foreign Assets Controls (OFAC). As these are both Treasury programs, the implementation of the outbound investment program is likely to borrow from the legal rules, interpretations, and practices of both OFAC and CFIUS, as well as reflect input from the Department of Commerce (Commerce) regarding sensitive technologies and products.

This Client Alert presents five key takeaways from the EO and ANPRM.

1. The regulations will apply to US persons investing in China in three key sectors

The EO directs Treasury, in consultation with Commerce and, as appropriate, other agencies, to determine sensitive technologies and products that are critical to the military, intelligence, surveillance, or cyber-enabled capabilities of a “country of concern” in the following three sectors (collectively, the “covered national security technologies and products”):

- semiconductors and microelectronics;
- quantum information technologies; and
- artificial intelligence (AI).

The EO defines “country of concern” as a country or territory “engaging in a comprehensive, long-term strategy that directs, facilitates, or otherwise supports advancements in sensitive technologies and products that are critical to such country’s military, intelligence, surveillance, or cyber-related capabilities.” So far the only country of concern identified by the White House is China.

The EO defines “US person” as any United States citizen, lawful permanent resident of the United States (so-called “green card” holder), 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 physically present in the United States. This is consistent with the definition of “US person” in sanctions programs implemented under IEEPA.

Like most OFAC sanctions programs implemented under IEEPA, the US person definition does not currently include non-US subsidiaries of US entities, but the EO authorizes Treasury to place responsibility on US persons to take “all reasonable steps” to comply with the regulations as to their controlled foreign entities. Treasury is considering defining a “controlled foreign entity” as a foreign entity in which a US person owns, directly or indirectly, a 50% or greater interest.

The EO also states that the regulations may prohibit US persons from “knowingly directing” a transaction if such transaction would be prohibited if engaged in by a US person. Treasury intends to use this authority to prevent “loopholes” by defining “direct” to mean ordering, deciding, approving, or otherwise causing a transaction that would be prohibited if the US person directly undertook such action. While these concepts are similar to the way in which OFAC implements US sanctions, Treasury’s proposed definition of “directing” would not implicate “facilitation” or conduct that is removed from the covered transaction itself — including, for example, the processing, clearing, or sending of payments by a bank.

2. Covered transactions that pose an acute national security threat will be prohibited; those that may contribute to the national security threat will require notification

The EO directs Treasury to issue regulations that will (i) identify and prohibit certain transactions that present a “particularly acute” national security threat (the “prohibited transactions”), and (ii) require US persons to notify Treasury of certain transactions that “may contribute to” the advancement by countries of concern in sensitive technologies and products critical for military, intelligence surveillance, or cyber-enabled capabilities (the “notifiable transactions”).

Treasury is considering defining both prohibited transactions and notifiable transactions (collectively, the “covered transactions”) to include the direct or indirect:

- acquisition of equity interest (e.g., via private equity, venture capital, mergers and acquisitions, and other arrangements);
- provision of convertible debt;
- greenfield investment; and
- establishment of certain joint ventures, in each case by a US person in a covered foreign person.

The EO defines “covered foreign person” as a person of a country of concern that is engaged in activities involving covered national security technologies or products. Treasury is considering elaborating on the covered foreign person definition to include (i) “a person of a country of concern” that is engaged in, or that a US person knows or should know will be engaged in, an identified activity with respect to a covered national security technology or product, and (ii) a person whose direct or indirect subsidiaries or branches meet the foregoing criteria and which, individually or in the aggregate, comprise more than 50% of such person’s consolidated revenue, net income, capital expenditure, or operating expenses. If adopted, this definition would exclude large conglomerates that may have some minimal activity in covered national security technologies or products.

If the knowledge standard described above is adopted, enforcement of the regulations would require that a US person knew, or reasonably should have known “based on publicly available information and other information available through a reasonable and appropriate amount of due diligence,” that a transaction was prohibited. US persons will want to consider record-keeping to demonstrate compliance and the statute of limitations for programs under IEEPA is generally five years. In addition to due diligence, US persons may want to consider contractual representations and warranties that address whether a target is a “person of a country of concern” and/or engaged in activities involving “covered national security technologies or products,” covenants and other contractual limitations on how the US person’s capital is used, and indemnification provisions.

In the EO, “person of a country of concern” is defined to include:

- any individual that is not a US person and is a citizen or permanent resident of a country of concern;
- any entity organized under the laws of a country of concern or with a principal place of business in a country of concern;
- the government of each country of concern, including any political subdivision, political party, agency, or instrumentality thereof, or any person owned, controlled, or directed by, or acting for or on behalf of the government of such country of concern; or
- any entity owned by any of the foregoing.

Treasury is considering including a threshold of a direct or indirect ownership interest of 50% or greater for the last prong, which would track the “50 percent rule” under US sanctions programs. This threshold would mean that a transaction in a third country, or even in the United States, could be a covered transaction.

Prohibited Transactions

The prohibited transactions are intended to be narrowly tailored to address a subset of highly sensitive covered national security technologies and products. The ANPRM proposes to prohibit covered transactions that involve covered foreign persons engaged in the following activities:

- **Semiconductors and microelectronics**
 - The development of electronic design automation software or semiconductor manufacturing equipment
 - The design, fabrication, or packaging of advanced integrated circuits
 - The installation or sale of supercomputers
- **Quantum information technologies**
 - The production of quantum computers and certain components
 - The development of certain quantum sensors
 - The development of quantum networking and quantum communication systems

Notifiable Transactions

The objective of the notification requirement is to increase the US government's visibility into the volume and nature of certain investments by US persons and thus will cover a broader set of covered national security technologies and products. The ANPRM proposes to require notification for covered transactions that involve covered foreign persons engaged in the following activities:

- **Semiconductors and microelectronics**
 - The design, fabrication, or packaging of less advanced integrated circuits not covered by the prohibitions on certain transactions involving semiconductors and microelectronics
- **AI systems**
 - Activities related to software that incorporates an AI system and is designed for certain end-uses that may have military or intelligence applications and pose a national security risk

Treasury is considering requiring notifications to be filed no later than 30 days *following* the closing via an electronic portal hosted on Treasury's website. Unlike the CFIUS review process, Treasury will not clear covered transactions under the proposed outbound investment program.

3. Transactions that present a lower risk will be excluded

In the ANPRM, Treasury explains that it intends to minimize "unintended consequences" and focus on transactions that present a higher national security risk. In an August 10, 2023 press briefing, senior administration officials communicated that the EO is not trying to prevent money from going into China but rather is focused on preventing the transfer of US "know-how." Accordingly, certain "excepted transactions" will be excluded from the scope of the outbound investment program. These are generally

certain passive investments that are unlikely to involve the transfer of both capital and additional benefits to a covered foreign person. Treasury is considering defining “excepted transactions” to include:

- an investment into a publicly traded security; an index fund, mutual fund, exchange-traded fund, or a similar instrument; or a *de minimis* investment made as a limited partner in an investment fund where the limited partner cannot make managerial decisions, is not responsible for debts beyond its investment, and does not have the ability (formally or informally) to influence or participate in a fund’s or a covered foreign person’s decision-making or operations;
- a 100% acquisition by a US person of all of the equity, assets, or other interests held by a covered foreign person in an entity located outside of a country of concern (e.g., a purchase of a non-Chinese subsidiary of a Chinese company);
- an intracompany transfer of funds from a US parent company to a subsidiary; and
- a transaction made pursuant to a binding, uncalled capital commitment entered into before the date of the EO.

Neither the EO nor the ANPRM indicates what the *de minimis* threshold will be or whether it will be based on the size of the limited partner’s investment, total assets under management, or other factors. Treasury is considering a high threshold where there is a likelihood of additional benefits being conveyed (e.g., managerial assistance, investment and talent networks, market access).

Although “influence or participation in decision-making or operations” is not defined, the ANPRM indicates that rights beyond standard minority shareholder protections may cause a transaction to fall outside of the exception. Such rights include membership or observer rights on the board of the covered foreign person, or any other involvement beyond the voting of shares in substantive business decisions, management, or strategy of the covered foreign person. This generally tracks the language for covered investment rights under the CFIUS regulations. The CFIUS regulations carve out membership on a limited partner advisory committee, and it is not clear whether Treasury will follow the same approach for the outbound investment program. To ensure that an investment qualifies as an excepted transaction, investment funds may want to consider carefully the rights that limited partners obtain (e.g., in side letters).

Treasury has also indicated that the following activities are generally expected to fall outside the definition of covered transactions:

- university-to-university research collaborations;
- contractual arrangements or the procurement of material inputs for any of the covered national security technologies or products (such as raw materials);
- intellectual property licensing arrangements;
- bank lending;
- the processing, clearing, or sending of payments by a bank;
- underwriting services;
- debt rating services;

- prime brokerage;
- global custody; and
- equity research or analysis.

The EO authorizes Treasury to exempt from applicable prohibitions or notification requirements any transactions that are in the national interest of the United States. This suggests some process for authorizations, similar to OFAC licenses and Treasury has indicated that it likely would need to review individual transactions for a national security exemption. The ANPRM, however, suggests that the bar for any such exemptions will be high, i.e., only when a particular transaction provides an “extraordinary benefit to US national security.” Additionally, Treasury is not considering granting any waivers or exemptions after a prohibited transaction has already been completed.

4. Many key questions still need to be addressed by the regulations; implementation of the EO is not expected until 2024

Importantly, the EO does not impose immediate prohibitions or notification requirements. Instead, the EO requires Treasury to issue regulations implementing the outbound investment program that the EO contemplates, in consultation with Commerce and other relevant executive departments and agencies. Treasury intends for the regulations to be forward-looking (i.e., without retroactive application). That said, the ANPRM indicates that Treasury may request information about transactions that were completed or agreed to after the issuance of the EO to inform the development and implementation of the program.

Treasury issued the ANPRM to share its proposed approach to implementation of the outbound investment program and obtain early stakeholder input. The ANPRM contains 83 questions for public comments. The questions are largely open-ended and cover a wide range of definitions and elements of the program. For example, the acquisition by a US person of a majority voting interest in a Chinese company that produces quantum computers is likely to be prohibited. Conversely, passive investments, e.g., through an index fund, in publicly traded Chinese companies will likely be unaffected. What is not clear is how broadly or narrowly the regulations will define the parameters of the outbound investment program and important issues remain to be clarified, including but not limited to the *de minimis* threshold for limited partners in investment funds and what contractual limitations US investors will need in place in order to participate in a financing vehicle that contemplates multiple funding rounds.

The public has 45 days to send comments to inform Treasury’s development of the regulations (i.e., by September 28, 2023). Treasury will then publish draft regulations, which will be subject to a public notice and comment process. Treasury will consider and respond to comments in finalizing the regulations. The EO does not contain a deadline for the issuance of the implementing regulations, which may take several months, or longer. Consequently, implementing regulations are unlikely to be effective at least until the second half of 2024.

The EO requires Treasury to assess the implementing regulations within one year of their effective date and periodically thereafter, including whether to revise the definition of covered national security technologies and products. It would be reasonable to anticipate that certain technologies or products within the three sectors identified in the EO may be added in the future.

The EO authorizes Treasury to take actions necessary to carry out its purposes, including to investigate potential violations of the EO or its implementing regulations and to nullify, void, or otherwise compel the divestment of any prohibited transactions. Notably, the ANPRM indicates that Treasury will not “use this

authority to unwind a transaction that was not prohibited at the time it was completed.” President Biden issued the EO pursuant to his authority under IEEPA, a statute that the President frequently uses to issue national security-related actions, such as economic sanctions. IEEPA provides for both criminal and civil penalties. Treasury is considering civil penalties up to the maximum allowed under IEEPA — the greater of \$356,579 (as of 2023) or twice the amount of the transaction — for (i) undertaking a prohibited transaction, (ii) material misstatements or omissions, or (iii) failure to timely report a notifiable transaction.

5. Congress remains focused on outbound investment

In July 2023, the Senate passed its version of the FY 2024 National Defense Authorization Act (NDAA), which includes the [Outbound Investment Transparency Act of 2023](#). The bill would require US firms to notify Treasury 14 days prior to making certain investments in “countries of concern,” defined to include China, Russia, Iran, and North Korea. The investments to be notified would include joint ventures, greenfield investments, and investments providing “know-how” via technology transfers, board representation, or the provision of business services, in the following sectors: advanced semiconductors and microelectronics; AI; quantum information science and technology; hypersonics; satellite-based communications; and network laser scanning systems with dual-use applications. Over the coming months, members of the Senate and House of Representatives will work to reconcile the two chambers’ versions of the NDAA. Thus, the fate of this bill remains uncertain.

Separately, the House Select Committee on China (the Committee) has been advocating for the restriction of outbound “problematic investments” in China. In a [letter](#) to President Biden on August 3, 2023, the Committee called on the administration to establish investment rules that would restrict both private outbound investments (such as venture capital and private equity funding) and public outbound investments (such as US purchases of Chinese stocks and bonds and investments in funds with Chinese portfolio companies) in the three sectors covered in the EO (semiconductors and microelectronics, quantum information technologies, and AI) as well as hypersonics, networked sensors and sensing, biotechnologies, and advanced computing, among others.

Notably, the Chairman of the Committee, Representative Mike Gallagher, [described](#) the EO as “a small step” but remarked that the EO does not address “passive flows of US money” into China. The Committee’s Ranking Member, Representative Raja Krishnamoorthi similarly [described](#) the EO as “an essential step,” but noted that “it cannot be the final step.”

Conclusion

The EO signals a novel shift in the US government’s approach to outbound investment and the protection of US national security. Although regulations that have yet to be issued will determine the exact scope of this new program, bipartisan congressional support for this regime suggests that regulation of outbound investment is likely to expand in the coming years. US investors should establish compliance procedures and start considering structuring transactions and contractual terms to prepare for implementation of the outbound investment program.

The government of China will likely take actions in response to the EO. On August 13, 2023, China’s State Council [issued](#) a document with 24 guidelines that authorities said would further optimize the country’s foreign investment environment and attract more foreign investment by protecting the rights and interests of foreign investors, including strengthening enforcement of intellectual property rights and increasing fiscal support and tax incentives for foreign investment.

Latham & Watkins will continue to monitor and report on developments related to the EO and ANPRM.

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