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To read the Executive Order, please click here.

To read the Advance Notice of Proposed Rulemaking, please click here.

To read the CFIUS Annual Report to Congress for CY 2022, please click here.

Report from Washington

President Biden Issues Executive Order Establishing Outbound Investment Regime

August 9, 2023

On August 9, 2023, President Biden issued an Executive Order on *Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern* (the "Order"), the first step in establishing a much-anticipated, new outbound investment regime. The Order is intended to regulate investment from the United States into China (and other jurisdictions that may be later identified as a country of concern) or Chinese-companies (including evergreen and joint venture investments implicating China) relating to three key sectors: (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) artificial intelligence. Citing national security concerns, particularly with respect to technological advancements that could provide military advantages to China, the Order establishes a new regime that will in some circumstances prohibit, and in others require notification of, certain investments by U.S. persons (and likely non-U.S. entities controlled by U.S. persons as well) in or relating to China. Concurrent with the issuance of the Order, the Department of the Treasury ("Treasury") issued an Advance Notice of Proposed Rulemaking ("ANPRM") that provides further details and color on the Biden Administration's proposed scope of the new outbound investment regime, which is not expected to come into force until 2024. In the interim, the ANPRM presents eighty-three questions for comment and affords an opportunity for feedback.

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Today's announcements stress that the new regime is not intended to prohibit or impede all U.S. investment in China, and will instead focus on a discrete set of transactions that are most likely to harm U.S. national security interests. Nevertheless, dealmakers, asset managers, institutional investors, and U.S. businesses and even some non-U.S. businesses should pay close attention to the forthcoming rules as they consider their long-term investment strategy relating to China, as they may soon need to consider this new outbound investment regime as part of any multi-jurisdictional filing assessment for prospective cross-border transactions. Notably, the actions announced through the Order and ANPRM are also consistent with several related efforts by Congress, other regulatory programs and the Administration to protect sensitive technologies from exploitation from foreign adversaries through legislation and executive action.

Indeed, the Order and the ANPRM invoke concepts and principles from a range of existing laws and regulations, including economic sanctions laws and regulations administered by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") and the Export Administration Regulations and related trade controls ("Export Regulations"), as well as practices of the Committee on Foreign Investment in the United States ("CFIUS" or "the Committee"). Thus, while the program is, in many ways, new and subject to further clarification and extrapolation, certain concepts contained in the new program will be based on how these other laws and regulations are applied.

Sectors Covered by the New Regime

The Order identifies three categories of national security technologies and products that will be the subject of the forthcoming regime: (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) artificial intelligence.

The Order is based on the premise that China has sought to exploit U.S. investments in China in order to develop sensitive technologies and products that are considered critical for military, intelligence, surveillance, and cyber-enabled capabilities. According to the Order, certain U.S. investments may accelerate development of sensitive technologies and products in China, and in some cases can offer recipients with intangible benefits. On that basis, the Order tasks the Secretary of the Treasury, in consultation with the Secretary of the Department of Commerce, to identify categories of notifiable transactions that involve "covered national security technologies and products" that "may contribute to the threat to the national security of the United States," and to identify categories of prohibited transactions that "pose a particularly acute national security threat because of their potential to significantly advance China's military, intelligence, surveillance, or cyber-enabled capabilities."

As noted above, the Order identifies three categories of national security technologies and products that will be the subject of the forthcoming regime: (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) artificial intelligence. The ANPRM clarifies the types of activities and technologies for which U.S. investment will be prohibited or notifiable within each of these three sectors, with further details summarized in the annex accompanying this report.

The ANPRM does not presently contemplate that Treasury will review on a case-by-case basis transactions subject to the notification requirement. Instead, parties are expected to self-determine whether a transaction is prohibited or notifiable.

Transactions That May Be Subject to the New Regime

According to the ANPRM, transactions proposed to be covered by the new regime include acquisitions of equity interests (*e.g.*, mergers and acquisitions, private equity, and venture capital investments), greenfield opportunities, joint ventures, and certain convertible debt financing. The ANPRM contemplates that certain carveouts or exceptions may be promulgated in the implementing regulations, such as investments in publicly-traded securities or exchange-traded funds.

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As relevant for the asset management community, the ANPRM also proposes exceptions for U.S. limited partners in private equity funds, venture capital funds, fund of funds, and other pooled investment funds, so long as the limited partner's contribution is: (1) a passive financial investment, with no ability to influence or participate in the fund's or the investment's decision making or operations; and (2) below a *de minimis* threshold to be determined by forthcoming regulations but potentially considering the size of the limited partner's investment in the fund or the size of the limited partner itself. The ANPRM also outlines a number of "non-standard" minority investor protections that would, if employed, take a limited partner investment outside the exception; these "non-standard" minority investor protections include membership or observer rights, nomination rights, rights that authorize the involvement in substantive business decisions, management or strategy. As a result, limited partner investments into non-U.S. investment funds could still be subject to the regime.

The ANPRM also proposes that certain other conduct fall outside the scope of the new regime, including activities such as university-to-university research collaborations; contractual arrangements or the procurement of material inputs 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; equity research or analysis; or other services secondary to a transaction.

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The ANPRM also acknowledges that certain prohibited transactions may be exempted in exceptional circumstances if they would provide significant benefits to national security or the national interest.

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Content of the Notices

The ANPRM proposes that notifiable transactions may require the parties to furnish, among other things, (i) the identity of the person(s) engaged in the transaction and nationality (for individuals) or place of incorporation or other legal organization (for entities); (ii) basic business information about the parties to the transaction, including name, location(s), business identifiers, key personnel, and beneficial ownership; (iii) the relevant or expected date of the transaction; (iv) the nature of the transaction, including how it will be effectuated, the value, and a brief statement of business rationale; (v) a description of the basis for determining that the transaction is a covered transaction—including identifying the covered national security technologies and products of the covered foreign person; (vi) additional transaction information including transaction documents, any agreements or options to undertake future transactions, partnership agreements, integration agreements, or other side agreements relating to the transaction with the covered foreign person and a description of rights or other involvement afforded to the U.S. person(s); (vii) additional detailed information about the covered foreign person, which could include products, services, research and development, business plans, and commercial and government relationships with a country of concern; (viii) a description of due diligence conducted regarding the investment; (ix) information about previous transactions made by the U.S. person into the covered foreign person that is the subject of the notification, as well as planned or contemplated future investments into such covered foreign person; and (x) additional details and information about the U.S. person, such as its primary business activities and plans for growth.

The public has 45 days to file comments with Treasury in response to the ANPRM, after which Treasury will commence with substantive drafting of the implementing regulations. Due to the time required for the rulemaking process, the new regime is not expected to come into force until 2024.

The notification is contemplated as a post-closing submission, filed no later than 30 days following closing of the transaction. Similar to the process currently in place for filings submitted to CFIUS, filings under the new program will be submitted via an electronic portal. Submissions would not be provided to the public unless required by law or in certain limited circumstances.

Impact on Investment Community

The public has 45 days to file comments with Treasury in response to the ANPRM, after which Treasury will commence with substantive drafting of the implementing regulations. Due to the time required for the rulemaking process, the new regime is not expected to come into force until 2024. Until then, asset managers, investors and other players in the financial services space (including lenders with conversion rights), should evaluate which of their financial activities are likely to be deemed within scope of the new regime, both because they might involve "U.S. persons" and because they might involve sensitive technologies.

U.S. companies, asset managers, and investors should take note of the forthcoming restrictions as they evaluate potential investment opportunities with touchpoints to China. Once the regime is implemented, U.S. investors will certainly need to consider confirmatory diligence as appropriate to determine whether particular transactions are prohibited or require notification. And while the Order does not prohibit existing investments, the new regime may nevertheless impact the long-term valuation of investments in China covered under the regime, as additional regulatory hurdles imposed on prospective U.S. investors could delay or otherwise impact exit opportunities.

Today's announcements are likely to prompt U.S. allies to establish their own analogous outbound investment regimes, and we expect similar proposals modeled after these new rules to be forthcoming in other jurisdictions moving forward.

In addition, non-U.S. asset managers should also take heed of the restrictions and notification requirements as they manage their relationships with U.S. limited partner investors. Depending on how Treasury ultimately crafts the rules governing investment funds, some U.S. limited partners may also require sponsors to afford them with relevant excuse rights for covered transactions, and may not be able to participate as a significant coinvestor on certain transactions involving China.

Today's announcements are likely to prompt U.S. allies to establish their own analogous outbound investment regimes, and we expect similar proposals modeled after these new rules to be forthcoming in other jurisdictions moving forward. Paul Rosen, the current Assistant Secretary for Investment Security, testified to Congress earlier this year that CFIUS representatives have now established a process to assist parties and allies with their foreign investment screening mechanisms, helping establish and modernize these regimes in over 20 other countries. And, in May, top Biden administration officials met with representatives of the European Union, issuing a joint statement afterwards noting that new measures designed to address risks from outbound investment will be an important tool that would complement existing efforts on foreign investment screening practices.

The Order also comes on the heels of the Committee's annual report (the "Report"), issued on July 31, 2023, which documented record levels of engagement by dealmakers with the Committee in 2022, notwithstanding a downturn in overall M&A activity that year. The Report detailed increasing case volumes, longer review periods with more transactions subject to investigation, increased reliance by the Committee on the use of mitigation in order to clear transactions, and an increase in the number of non-notified transactions for which the Committee sought a post-closing filing. Against this backdrop, the enactment of a new outbound investment regime further expands the Biden Administration's ability to regulate cross-border transactions and foreign investment as a means to advance the country's national security interests.

Simpson Thacher & Bartlett LLP is experienced in navigating the complexities of foreign investment screening and the CFIUS review process, and continues to follow developments of this new outbound investment review regime closely. We are available to discuss further questions on request.

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Annex

Sector	Activities and Technology Proposed to Be Prohibited	Activities and Technology Proposed to Be Notifiable
Semiconductors & Microelectronics	(i) Specific technology, equipment, and capabilities that enable the design and production of advanced integrated circuits or enhance their performance (ii) Advanced integrated circuit design, fabrication, and packaging capabilities (iii) The installation or sale of certain supercomputers, which are enabled by advanced integrated circuits	Design, fabrication, and packaging of certain other integrated circuits that do not fall within a category that is prohibited
Quantum Information Technologies	(i) Quantum computers and components, dilution refrigerators, or two-state pulse tube cryocoolers (ii) Quantum sensors designed to be used exclusively for military end uses, government intelligence, or mass-surveillance (iii) Quantum networking and communications systems designed to be used exclusively for secure communications	None under consideration
Artificial Intelligence	Development of software that incorporates an artificial intelligence system and is designed to be used primarily or exclusively for military, government intelligence, or mass-surveillance end uses	Development of software that incorporates an artificial intelligence system and is designed to be used primarily or exclusively for cybersecurity applications, digital forensics tools, and penetration testing tools; the control of robotic systems; surreptitious listening devices that can intercept live conversations without the consent of the parties involved; non-cooperative location tracking; or facial recognition