

## U.S. Announces New Restrictions on Outbound Investments to China

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Earlier this month, on August 9, 2023, the Biden administration issued its long-awaited Executive Order (the E.O.) announcing new restrictions on the ability of U.S. persons to invest in Chinese companies developing certain types of sensitive technologies and products. The new E.O., titled “[Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern](#),” directs the U.S. Department of the Treasury (Treasury) to issue regulations that will either prohibit or require notification of outbound investments in Chinese companies undertaking identified activities relating to certain products and technologies in the following three industry sectors: (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence.

The same day that the White House issued its new E.O., Treasury published an [Advance Notice of Proposed Rulemaking](#) (ANPRM) providing an initial framework for what Treasury is calling the “outbound investment program.” The ANPRM is a very well-written and thought-out document that provides early, comprehensive drafts of some of the key definitions that will determine the scope of the outbound investment program. The ANPRM requests comments from the public on the scope of its proposed definitions to ensure that Treasury’s regulations address the national security concerns outlined in the E.O. but do not have unintended consequences for the investment community. Stakeholders have until **September 28, 2023**, to submit comments to Treasury.

The new outbound investment program envisioned by the E.O. and ANPRM will have significant implications for U.S. private equity and venture capital firms that do business in China, particularly those that invest in the semiconductor industry. Private equity and venture capital investors should review the E.O. and ANPRM carefully, think through how the current scope of the definitions of key terms in the ANPRM would apply to their businesses, and engage with Treasury to ensure that the outbound investment program is scoped reasonably. If you or your company have questions about the outbound investment program or would like to submit comments to the ANPRM, please contact the authors of this article or your relationship partner.

### I. E.O.

On August 9, President Biden issued the E.O. pursuant to his authority under the Constitution and the laws of the United States, the International Emergency Economic Powers Act (IEEPA), the National Emergencies Act (NEA), and section 301 of title 3, United States Code. In the E.O., the President declares a national emergency relating to the

advancement by “countries of concern” in sensitive technologies and products critical for military, intelligence, surveillance, or cyber-enabled capabilities. The only “country of concern” listed in the Annex to the E.O. is the People’s Republic of China (including the Special Administrative Regions of Hong Kong and Macau). Thus, although not mentioned in the title of the E.O., the sole focus of the new outbound investment program is China.

To assist in addressing the national emergency identified in the E.O., the President directs Treasury to issue regulations that either prohibit certain outbound investments in China or require notification to Treasury.

Specifically, the E.O. directs Treasury—in consultation with the Department of Commerce (“Commerce”) and, as appropriate, the heads of other agencies—to identify transactions involving “covered national security technologies and products” that pose an “acute” national security threat because of “their potential to significantly advance the military, intelligence, surveillance, or cyber-enabled capabilities of countries of concern.” The E.O. states that Treasury’s regulations shall prohibit U.S. persons from engaging, directly or indirectly, in such transactions.

The E.O. further directs Treasury—in consultation with Commerce and, as appropriate, the heads of other agencies—to identify transactions involving “covered national security technologies and products” that “may contribute” to the threat to U.S. national security identified in the E.O. The E.O. states that Treasury’s regulations shall require U.S. persons to notify Treasury of each such transaction.

The E.O. defines “covered national security technologies and products” to mean “sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and artificial intelligence sectors that are critical for the military, intelligence, surveillance, or cyber-enabled capabilities of a country of concern.”

Thus, the E.O. requires Treasury to identify sensitive technologies and products that fall within the three industry sectors listed above—(1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence. If China’s development of a technology or product would present an “acute” threat to U.S. national security, then Treasury is authorized to issue regulations prohibiting U.S. persons from making outbound investments in Chinese companies working on those technologies. If China’s development of a technology or product would not present an “acute” threat but “may contribute” to the threat to U.S. national security posed by China, then Treasury is authorized to issue regulations directing U.S. persons to notify Treasury about such investments.

## II. ANPRM

The ANPRM notes that Treasury is considering implementing the E.O. by establishing a new outbound investment program. Unlike the Committee on Foreign Investment in the United States (CFIUS), Treasury’s current thinking is that the outbound investment program will not review transactions on a case-by-case basis. Rather, investors would be responsible for reviewing the regulations and making their own determination on whether a particular investment is prohibited, requires notification, or can be made without notification.

The ANPRM notes that the outbound investment program is not intended to prohibit all investments in China. Nor is it intended to create sector-wide bans on all investments in semiconductors and microelectronics, quantum information technologies, and artificial intelligence. Rather, per the ANPRM, the program will be designed to prohibit or require notification of investments in Chinese companies working on a narrow, targeted set of “covered national security technologies and products” within those three industry sectors.

The ANPRM states that Treasury does not intend for the outbound investment program to apply retroactively. Thus, if an investor makes investments, or enters into binding commitments to make future investments, between now and whenever the final regulations are published, Treasury will not penalize the investor for making investments in violation of the regulations. However, the ANPRM cautions that Treasury reserves the right to request information from U.S. investors about outbound investments made after the effective date of the E.O.

After giving an overview of the outbound investment program, the ANPRM provides draft provisions for several key definitions, including “U.S. person,” “covered foreign person,” “person of a country of concern,” “covered

transactions,” “excepted transactions,” and “covered national security technologies and products.” Following each definition, the ANPRM includes a series of questions designed to solicit feedback from stakeholders.

Based on the ANPRM’s proposed definitions, it appears that Treasury envisions publishing regulations that would require notification or prohibition of transactions where a “U.S person” engages in a “covered transaction” involving a “covered foreign person.” The ANPRM defines a “covered transaction” broadly to include equity investments, debt financing, greenfield investments, and joint ventures, and the ANPRM defines “covered foreign person,” in essence, to mean a Chinese company that is undertaking identified activities (e.g., design, develop, produce, fabricate) relating to “covered national security technologies and products.”

Notably, Treasury has already given some thought to the specific technologies and products that will qualify as “covered national security technologies and products” within the meaning of the E.O. Per the ANPRM, U.S. persons will be prohibited from engaging in, or required to notify Treasury of, transactions involving Chinese companies engaged in the identified activities relating to the following “covered national security technologies and products.”

## Prohibited Transactions

INDUSTRY SECTOR	ACTIVITIES	“COVERED NATIONAL SECURITY TECHNOLOGIES OR PRODUCTS”
Semiconductors and Microelectronics	Develop, produce	Electronic Design Automation (EDA) software designed to be exclusively used for integrated circuit design
Semiconductors and Microelectronics	Develop, produce	Front-end fabrication equipment designed to be exclusively used for the volume fabrication of integrated circuits
Semiconductors and Microelectronics	Design	Integrated circuits that exceed the thresholds in Export Control Classification Number (ECCN) 3A090 in the Export Administration Regulations (EAR) or integrated circuits designed for operation at or below 4.5 Kelvin
Semiconductors and Microelectronics	Fabricate	Integrated circuits that meet any of the following criteria: <ul style="list-style-type: none"> <li>i. Logic integrated circuits using a non-planar</li> </ul>

transistor architecture or with a technology node of 16/14 nanometers or less, including but not limited to fully depleted silicon-on-insulator (FDSOI)

ii. NOT-AND (NAND) memory integrated circuits with 128 layers or more

iii. Dynamic random-access memory (DRAM) integrated circuits using a technology node of 18 nanometer half-pitch or less

iv. Integrated circuits manufactured from a gallium-based compound semiconductor

v. Integrated circuits using graphene transistors or carbon nanotubes

vi. Integrated circuits designed for operation at or below 4.5 Kelvin

“Fabrication of integrated circuits” is defined as “the process of forming devices such as transistors, poly capacitors, non-metal resistors, and diodes, on a wafer of semiconductor material.”

Semiconductors and Microelectronics

Package

Integrated circuits that support the three-dimensional integration of integrated circuits, using silicon vias or through mold vias.

“Packaging of integrated circuits” is designed as “the assembly of various components, such as

		the integrated circuit die, lead frames, interconnects, and substrate materials, to form a complete package that safeguards the semiconductor device and provides electrical connections between different parts of the die.”
Semiconductors and Microelectronics	Install, Sell	Supercomputers, which are enabled by advanced integrated circuits, that can provide a theoretical compute capacity of 100 or more double-precision (64-bit) petaflops or 200 or more single-precision (32-bit) petaflops of processing power within a 41,6000 cubic foot or smaller envelope
Quantum Information Technologies	Produce	Any of the following: Quantum computer, dilution refrigerator, or two-stage pulse tube cryocooler. “Quantum computer” is defined as “a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference, or entanglement.”
Quantum Information Technologies	Develop	A quantum sensing platform designed to be exclusively used for military end uses, government intelligence, or mass-surveillance end uses
Quantum Information Technologies	Develop	A quantum network or quantum communication system designed to be exclusively used for secure communications, such

as  
quantum key distribution

Artificial Intelligence

Develop

Based on the ANPRM, it is not clear that Treasury will announce any prohibited transactions in the artificial intelligence sector. The ANPRM notes that if Treasury were to pursue a prohibition in this category, a “potential approach” is to focus on U.S. investments in Chinese companies engaged in “the development of software that incorporates an AI system and is designed to be exclusively used for military, government intelligence, or mass-surveillance end uses.” Alternatively, “primarily used” could take the place of “exclusively used.”

## Notifiable Transactions

INDUSTRY SECTOR	ACTIVITIES	“COVERED NATIONAL SECURITY TECHNOLOGIES OR PRODUCTS”
Semiconductors and Microelectronics	Design, Fabricate, Package	Integrated circuits for which transactions involving U.S. persons are not otherwise prohibited
Artificial Intelligence	Develop	The ANPRM notes that Treasury is considering a notification requirement for situations where the Chinese business is “engaged in the development of software that incorporates an artificial intelligence system and

is designed to be exclusively used for: cybersecurity applications, digital forensics tools, and penetration testing tools; the control of robotic systems; surreptitious listening devices that can be intercept live conversations without the consent of the parties involved; non-cooperative location tracking (including international mobile subscriber identify (IMSI) Catchers and automatic license plate readers); or facial recognition.”

Treasury is considering defining “AI system” as “an engineered or machine-based system that can, for a given set of objectives, generate outputs such as predictions, recommendations, or decisions influencing real or virtual environments. AI systems are designed to operate with varying levels of autonomy.”

As the chart indicates, most of the proposed prohibitions and notifications involve technologies and products in the semiconductor and microelectronics sector. Treasury is considering certain prohibitions (but not notifications) for the quantum information technology sector. Finally, Treasury appears to be uncertain about what to do with the artificial intelligence sector. The ANPRM suggests that Treasury is still trying to decide whether the artificial intelligence sector should include prohibitions, notifications, or nothing.

### III. Key Questions and Answers

**1. Who’s in charge of the outbound investment program?** Unlike CFIUS, which is an interagency committee composed of nine voting members that acts on the basis of unanimity, the outbound investment program will be implemented and administered by Treasury. The E.O. makes clear that, on certain issues, Treasury is required to consult with Commerce and, as appropriate, the head of other relevant agencies. But it appears that Treasury will be the ultimate decision maker on all the key issues relating to the scope of the regulations and the administration of the program.

**2. What office within Treasury will be responsible for administering the outbound investment program?** It will likely be the Office of Investment Security, the same office that manages the CFIUS process. The policy team for the Office of Investment Security was responsible for drafting the ANPRM, and it would make sense to assign the responsibility for administering the program to the same office.

**3. What countries are subject to the outbound investment program?** The E.O. states that the new restrictions on outbound investments will apply to “countries of concern,” but the only “country of concern” identified in the Annex to the E.O. is China (including the Special Administrative Regions of Macau and Hong Kong).

**4. Can other countries be added to the list of “countries of concern”?** The E.O. defines a “country of concern” as “a country or territory listed in the Annex to this order that *the President has identified* to be 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-enabled capabilities.” (emphasis added). Based on the definition, it appears that only the President can identify new “countries of concern,” and that the President would have to do so by issuing an updated Annex.

**5. What types of outbound investments would be subject to the proposed regulations?** The new regulations would prohibit “U.S. persons” from investing in Chinese companies engaged in certain activities with respect to “covered national security technologies and products.” The term “covered national security technologies and products” means certain technologies and products identified by Treasury (in consultation with Commerce and, as needed, heads of other agencies) within the following three industry sectors: (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence. As noted above, the ANPRM already includes an early draft of the types of technologies and products that would qualify as “covered national security technologies and products,” and most of those technologies and products are in the semiconductors and microelectronics sector.

**6. Can Treasury expand the outbound investment program beyond the three industry sectors identified in the E.O.?** It appears that Treasury has the authority to issue regulations identifying the specific types of technologies and products within the three industry sectors identified in the E.O., but it does not have the authority to add to those sectors. That would have to be done by the President in the form of an updated E.O.

**7. Who decides which technologies and products meet the definition of “covered national security technologies and products”?** Treasury has to consult with Commerce and other agencies, as needed, but Treasury appears to be the ultimate decision maker.

**8. Does the new regime apply only to equity investments?** Those who are familiar with CFIUS know that CFIUS only has the authority to screen equity investments in U.S. businesses. CFIUS has no jurisdiction where a foreign person gives a loan to a U.S. business, makes a “greenfield” investment in the United States, or forms a joint venture that does not involve the contribution of a U.S. business. The ANPRM makes clear that the outbound investment screening program will be different. Unlike CFIUS, the outbound investment program will apply to multiple types of outbound investments, including certain types of equity investments, debt investments, greenfield investments, and joint ventures.

**9. What are “excepted transactions”?** The ANPRM notes that there may be some transactions that technically fall within the definition of a “covered transaction” but present a lower likelihood of raising the national security concerns outlined in the President’s E.O. Thus, in the ANRPM, Treasury states that it is considering a category of transactions that would be called “excepted transactions,” and these types of transactions would be excluded from the definition of “covered transaction.”

According to the proposed definition in the ANRPM, “excepted transactions” would be defined to include:

- (1) a passive investment (a) into a publicly traded security; (b) into an index fund, mutual fund, exchange-traded fund, or similar instrument; (c) made as a limited partner into a venture capital fund, private equity fund, fund of funds or other pooled investment funds;
- (2) the acquisition of the equity or other interest owned or held by a Chinese company in an entity or assets outside China where the U.S. person is acquiring all interests in the entity or assets held by the Chinese company;
- (3) an intracompany transfer of funds from a U.S. parent company to a subsidiary located in China; and



- (4) a transaction made pursuant to a binding, uncalled capital commitment entered into before the date of the E.O.

The ANPRM notes that in order to qualify as an “excepted transaction,” the U.S. person will not be able to obtain any rights in the Chinese company, other than standard minority-shareholder protections. Like CFIUS—but in reverse—U.S. persons will not be able to get board seats (or observer seats) on the Chinese business. They also cannot have any involvement in the management or substantive business decisions of the company.

The definition of “excepted transactions” will obviously be important for U.S. private equity and venture capital firms who want to continue to do business in China. Treasury is clearly trying to scope out the types of outbound investments that do not create the national security risks identified by the E.O. Private equity and venture capital firms should carefully review the “excepted transactions” definition and engage with Treasury on whether any changes should be made.

**10. Will Treasury’s regulations apply to foreign subsidiaries or branch offices of a U.S. investor?** The E.O. specifically states that Treasury has the authority to issue regulations that require U.S. persons to provide notification to Treasury of any transaction by a foreign entity controlled by such U.S. person that would be notifiable if engaged in by the U.S. person. Moreover, Treasury has the authority to issue regulations that require U.S. persons to take all reasonable steps to prohibit or prevent any transaction by a foreign entity controlled by such U.S. person that would be a prohibited transaction if engaged in by a U.S. person. The ANPRM notes that, pursuant to this authority, Treasury is considering rules that would place certain obligations on U.S. persons related to foreign entities they “control.” The ANPRM further notes that Treasury is considering defining a “controlled foreign entity” as a foreign entity in which a U.S. person controls, directly or indirectly, a 50% or greater interest. Thus, the outbound investment restrictions may apply to any U.S. investor and any entity in which the investor owns 50% or more of the ownership interest (regardless of where the entity is incorporated or has its principal place of business).

**11. Will the regulations apply to outbound investments in companies that are not physically located in China?** Per the ANPRM, the regulations would apply to “(1) any individual that is not a U.S. citizen or lawful permanent resident of the U.S. and is a citizen or permanent resident of a country of concern; (2) an entity with a principal place of business in, or an entity incorporated in or otherwise organized under the laws of a country of concern; (3) the government of a country of concern . . . ; or (4) any entity in which a person or persons identified in items (1) through (3) holds individually or in the aggregate, directly or indirectly, an ownership interest equal to or greater than 50 percent.” Thus, the regulations would apply to any company that is owned at least 50% by a Chinese individual, a Chinese entity, or the Chinese government, regardless of where the company is located. Per the ANPRM, a U.S. company could be subject to outbound investment restrictions if it is more than 50% owned by a Chinese citizen.

**12. What if an U.S. investor doesn’t know whether a Chinese entity is working on any of the “covered national security technologies and products” identified in the chart above?** Per the ANPRM, the outbound investment restrictions will apply only in situations where a U.S. person knows or should have known that the target entity was working on “covered national security technologies or products.”

**13. But what if the target entity does not develop “covered national security technologies or products,” but one of its subsidiaries does?** If a target business does not develop “covered national security technologies and products” but its subsidiary or branch office does, then the outbound investment restrictions may apply. Per the ANPRM, Treasury expects that if a U.S. person is investing in a company, the U.S. person will conduct enough diligence to know where the majority of the target business’s (i) revenues come from, (ii) capital expenditures are deployed, and (iii) expenses originate from. If the target business gets 50% or more of its revenues from, deploys 50% or more of its capital to, or spends 50% or more of its expenses on one or more subsidiaries or branches that are developing “covered national security technologies and products,” then the outbound investment restrictions will apply to an outbound investment in the target business.

**14. What is the ANPRM’s knowledge standard?** Per the ANPRM, Treasury is considering adopting a definition similar to that found in the EAR at 15 C.F.R. 772.1, where “knowledge” means knowledge of a circumstance, including not only positive knowledge that the circumstance exists or is substantially certain to occur but also an awareness of a high probability of its existence or future occurrence. Such awareness may be inferred from evidence of a person’s conscious disregard of facts known to that person.

According to Treasury, adopting a definition like this would mean that to be covered by the regulations, “a U.S. person would need to know, or reasonably should have known based on publicly available information and other information available through *a reasonable and appropriate amount of due diligence*, that it is undertaking a transaction involving a covered foreign person and that the transaction is a covered transaction.” (emphasis added).

Thus, if a U.S. person wants to invest in a Chinese company, it will have to perform “a reasonable and appropriate amount of due diligence” to determine whether the Chinese company or any of its subsidiaries or branches are developing any “covered national security technologies and products.” If they are, then the transaction may be prohibited or notifiable. Even if it is not publicly known that the Chinese company is developing “covered national security technologies and products,” the U.S. person could be penalized for violating the outbound investment program’s regulations if they do not perform “a reasonable and appropriate amount of due diligence” before making the investment.

**15. What happens if a U.S. investor violates the regulations?** Right now, the main remedy appears to be civil penalties. In addition, in cases where a transaction is prohibited by the regulations, Treasury can also compel divestment. The E.O. and ANPRM also note that Treasury has the ability to refer criminal charges to the Department of Justice. However, this will likely apply only in situations where there is willful misconduct.

**16. How many days would a U.S. investor have to wait before Treasury approves an outbound investment.** Zero days. As Treasury currently envisions the program, U.S. persons will not be required to submit notice of a particular investment and then wait for weeks (or months) for Treasury to approve the transaction before closing, which is a stark contrast from CFIUS. For prohibited transactions, U.S. persons simply cannot engage in the transactions. For notified transactions, Treasury’s current thinking is to require U.S. persons to submit their notice within 30 days after closing. In other words, the outbound investment program will not cause any delay for notified transactions. Investors can do their deals, and then worry about providing the requisite notice to Treasury.

**17. The outbound investment regime is not effective immediately, but investors shouldn’t ignore it.** As other commentators have observed, we’re still a long way off from the final regulations. Given the time it takes to complete the rulemaking process, Treasury likely will not issue final regulations until sometime next year. Moreover, investors should not have to worry about Treasury applying the outbound investment regime retroactively. Per the ANPRM, the prohibition and notification requirements should apply only to investments made after the final regulations are effective. That being said, Treasury also makes clear in the ANPRM that it reserves the right to request information about any investments that are made after the effective date of the E.O., which was August 9, 2023. Accordingly, investors are on notice that any investments they make from this point forward may be subject to information requests from CFIUS.

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