

Final outbound investment rule released

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The Treasury Department has released a final rule, effective January 2, 2025, that will impose extensive diligence requirements and, in some cases, prohibitions on U.S. investment in China-linked companies engaged in activities related to semiconductor manufacturing, quantum information technologies, and development of AI software.

On October 28, 2024, the Treasury Department issued a [final rule](#) (the Outbound Investment Rule) implementing [Executive Order 14105](#) and creating a regime restricting investment by U.S. persons in targeted sectors in “countries of concern” (currently limited to China). The final Outbound Investment Rule caps a long period of consultation beginning prior to an [advanced notice of proposed rulemaking](#) accompanying the executive order in August 2023 (discussed in [this client update](#)) and a [notice of proposed rulemaking](#) in June 2024 (the NPRM, discussed in [this client update](#)). This update focuses primarily on the content of the final rule rather than the incremental changes to previous proposals.

The Outbound Investment Rule tracks the NPRM and does little to resolve the uncertainties identified by commenters. At a high level, the outbound investment regime applies to:

- Equity investments by U.S. persons and entities they control (primarily, but not exclusively, acquisitions of non-publicly traded equity)
- made directly or indirectly in companies based in China, owned by Chinese interests, or with a majority of their revenue or expenses in China
- conducting targeted activities in one of three sectors:
 - i. semiconductors and microelectronics,
 - ii. quantum information technologies, and
 - iii. artificial intelligence (AI) models above specified thresholds of computing power or developed for specified end uses.

Not all investments in these sectors are restricted; as discussed below, there are detailed criteria to determine whether an investment is notifiable or prohibited.

The system does not provide for review or guidance from Treasury and instead places the burden on U.S. investors to identify transactions that are subject to prohibition or notification requirements under the regime, under threat of civil or (in the case of willful violations) criminal penalties. Investors are also charged not only with their actual knowledge of a company’s activities, but with information that they could have obtained through “reasonable and diligent inquiry,” as assessed after the fact by Treasury based on all the facts and circumstances. While the final rule provides some additional clarity over previous proposals, critical elements of the Outbound Investment Rule (most notably what a U.S. investor should have found in diligence) are broadly defined and leave considerable enforcement discretion to Treasury.

The Outbound Investment Rule will impose significant diligence and compliance burdens on investments by U.S. and U.S.-owned persons in companies operating in China in the targeted sectors, as well as risks to U.S.-based lenders to covered companies whose loans may be secured by restricted securities or assets (or that might be equitized in a restructuring).

Structure of the rule

The Outbound Investment Rule would impose prohibitions or notification requirements on “U.S. persons” in connection with “covered transactions” that would involve or create a “covered foreign person.” A covered foreign person is a “person of a country of concern” (currently only China) that engages in certain “covered activities” (such as research, development, or manufacturing) involving “covered national security technologies and products,” which are sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and AI sectors that have military, intelligence, surveillance, or cyber-enabled capabilities. Depending on the nature of the “covered activity,” a covered transaction may be prohibited (prohibited transactions) or require notification to Treasury (notifiable transactions).

What does the rule cover?

The core concept in the Outbound Investment Rule is a “**covered foreign person**,” which would mean an entity that is (1) Chinese or has a majority of its activities in China based on one of several measures, and (2) engages in a covered activity. (The Outbound Investment Rule applies generally to a “person of a country of concern”; currently, however, the only “country of concern” is China, including Hong Kong and Macau, though it is possible that the outbound investment control regime could later be expanded to other countries.) The rule also applies to “indirect” investments in covered foreign persons, and the scope of that application is somewhat unclear.

What entities are subject to investment restrictions?

Chinese entities

The base definition of “**person of a country of concern**” is straightforward. A “person of a country of concern” means: (a) any citizen or permanent resident of a country of concern who is not also a U.S. citizen or permanent resident (wherever located, and whether or not they are dual citizens of a non-U.S. country, so that, for example, a dual citizen of Canada and China living in Canada is covered); (b) an entity with a principal place of business in or incorporated in a country of concern; (c) the government of a country of concern and entities that are 50 percent or more state-owned; and (d) any entity that is 50 percent or more owned or controlled, directly or indirectly, by any of the foregoing.¹

Non-Chinese entities

The Outbound Investment Rule also captures entities that are not based in China or Chinese-owned if 50% or more of their revenues or expenses are derived from China. Specifically, a non-Chinese entity would be covered if (1) it holds a voting or equity interest (other than a limited set of excepted interests)² of any size in, or a board seat or power to direct or cause the direction of management or policies of, a covered Chinese entity, and (2) 50% or more of its revenue, net income, capital expenditure, or operating expenses are attributable to a Chinese entity engaged in a covered activity, based on the non-Chinese entity’s most recent financial statements. For example, this may capture a non-Chinese company that, in the prior year, had more than 50% of its capital expenditures in China because it was constructing a factory for a Chinese subsidiary engaged in covered activities. The assessment is to be made at the time of the transaction, unless the U.S. person has “knowledge” at the time of the investment that the investment target will exceed one of the thresholds.

Less clear is the Outbound Investment Rule’s applicability to “indirect” investments in entities that are persons of a country of concern. Unsurprisingly, the rule’s scope includes investments in persons of a country of concern through non-Chinese SPVs or other holding companies. The question, though, is whether investment in a more substantial parent entity with operations in China (which operations often would be carried out through a Chinese subsidiary that is necessarily a “person of a country of concern”) could be deemed an indirect investment in the subsidiary. Logically, the answer should be that if the Chinese entity within the group does not meet one of the 50% tests outlined above, an investment in the parent should not be deemed an indirect investment in the subsidiary (otherwise, the indirect investment rule would swamp the 50% rule and capture any company of any nationality with a Chinese subsidiary engaged in covered activities, no matter how small). The problem is that this point was raised in the comments to the NPRM, and Treasury explicitly rejected it, saying that the 50% rule was not intended to exclude the possibility that investment in an “intermediary” could be deemed an indirect investment in a Chinese company it owns (even if that Chinese subsidiary does not satisfy any of the revenue or expenditure tests above). This preserves Treasury’s flexibility to deem an investment to be covered by the Outbound Investment Rule after the fact but leaves investors with no guidance as to the criteria to be applied.

Sanctioned persons

The Outbound Investment Rule effectively expands sanctions against Chinese entities (or entities with a majority of their activities in China, as above) if they are also subject to U.S. export controls or sanctions. Entities on the Military End-User List, Military Intelligence End-User List, or Entity List maintained by the Department of Commerce, or the Chinese Military-Industrial Complex List maintained by the Office of Foreign Assets Control (OFAC)³ will be subject to an investment prohibition if they engage in any covered activity (even if it is only notifiable rather than prohibited activity).

What activities are targeted?

The Outbound Investment Rule would apply to investments in a person of a country of concern engaged in “**covered activities**.” Depending on the nature of those activities, the transaction would either be prohibited or notifiable. The covered activities that make a transaction notifiable versus prohibited are distinct and are not intended to overlap. Generally, activities and technology that are deemed to present the most acute national security concerns (e.g., development of AI technologies with mass-surveillance capabilities) would be prohibited, while other designated activities would be subject to notification requirements. The covered activities outlined in the Outbound Investment Rule are generally consistent with the NPRM.

Targeted industries

The three industries currently targeted are:

- **Semiconductors and microelectronics.** Supercomputers; electronic design automation software; certain fabrication and advanced packaging tools; certain software, equipment, or advanced packaging techniques related to the development of integrated circuits; and the design or fabrication of integrated circuits with special characteristics.
- **Quantum information technologies.** The development of quantum computers and critical components of quantum computers; the development of quantum sensing platforms; and the development of networks or communication systems designed or intended to scale up the capabilities of quantum computers, secure communication, or any military, government intelligence or mass-surveillance end use.
- **AI systems.** The development of any AI system that is designed exclusively for or intended to be used for military, government intelligence, or mass-surveillance end uses or that is trained using a specified quantity of computing power.

Covered activities may be either prohibited or notifiable and Treasury has indicated that it is likely to add to this list in the future as it gathers information and national security threats evolve.

A detailed breakdown of the criteria for inclusion is below as [Appendix A](#), but a high-level summary follows:

Prohibited activities

Semiconductors and microelectronics

- Developing or producing design automation software for integrated circuit design or advanced packaging;
- Developing or producing equipment for semiconductor fabrication, volume advanced packaging, or extreme ultraviolet lithography;
- Designing or fabricating integrated circuits exceeding specified performance characteristics;
- Using advanced integrated circuit packaging techniques; and
- Developing, installing, selling, or producing supercomputers exceeding specified performance and density criteria.

Quantum information technology

- Developing or producing quantum computers or critical components;
- Developing or producing quantum sensing platforms intended for military, intelligence, or mass-surveillance end uses; and
- Developing or producing quantum networks or quantum communication systems intended for scaling quantum computing, secure communications, or any application that has a military, intelligence, or mass-surveillance end use.

AI systems

- Developing AI systems designed exclusively for or intended to be used for military, government intelligence, or mass-surveillance end uses; and
- Developing AI systems trained using a quantity of computing power greater than 1025 computational operations (e.g., integer or floating-point operations), or 1024 computations in the case of systems trained using primarily biological sequence data (aggregating any models combined in a single system).

Notifiable activities

Semiconductors and microelectronics

- Designing any integrated circuit, other than prohibited integrated circuits;
- Fabricating any integrated circuit, other than prohibited integrated circuits; and
- Packaging any integrated circuit, other than prohibited packaging.

Quantum information technology

No notifiable activities.

AI systems

- Developing non-prohibited AI systems designed for any military, government intelligence, or mass-surveillance end use (i.e., AI systems that are not designed exclusively for such uses);
- Developing AI systems intended by the foreign person for cybersecurity, digital forensics, or penetration testing;
- Developing AI systems intended by the foreign person for controlling robotic systems; and
- Developing AI systems trained using more than 1023 computational operations (e.g., integer or floating-point operations).

What does “engages in covered activities” mean?

A critical component of the “covered foreign person” definition is whether the person of a country of concern “engages in” notifiable or critical activities. This definition has been clarified somewhat from the NPRM, though some points of ambiguity remain. The rule looks to whether the investment target, and not its parent or sister companies, engages in a covered activity. The treatment of activities engaged in by subsidiaries of the investment target is unclear. Presumably wholly owned subsidiaries of a person of a country of concern are within the scope of the prohibition on “indirect” investment (but see above for the open question of whether Chinese subsidiaries of non-Chinese companies that do not trigger the various 50% financial tests are covered). There is no guidance, though, on how to treat other indirect investments (e.g., shares issued by a Chinese software company that owns 25% of a company engaged in covered activities and provides non-covered services to that company). There is no *de minimis* threshold, even if the covered activities are unrelated to a U.S. person’s investment or intent.

Treasury responded to concerns regarding the temporal scope of the prohibition, especially for early-stage companies, by noting that that “engages in” is deliberately phrased in the present tense and is limited to the “knowledge” of the U.S. investor—but, as discussed below, the scope of “knowledge” is uncertain, and Treasury’s guidance goes on to state that even if a company does not currently “engage in” covered activity, the transaction is still covered if the pause is temporary or if the company is raising capital “for the specific purpose” of engaging in a covered activity. How Treasury would treat plans, of greater or lesser definiteness, to potentially engage in activities that could be “covered activities” in the future remains unclear.

The Outbound Investment Rule also provides clarification on what it means to “develop” a technology. “Develop” is defined as pre-production design and substantive modification, among other things.⁴ This is particularly important for AI systems, where the final rule clarifies that in order for a covered foreign person’s use of AI to be covered, it must engage in one of the listed activities (such as substantive design or modification), and merely customizing or configuring a third-party AI model or system for its own internal use does not constitute “developing” the system unless it is for one of the targeted end uses.

Who is a “U.S. person” required to comply with the rule?

The Outbound Investment Rule would apply to “U.S. persons,” which includes:

- any United States citizen or lawful permanent resident (“green card” holder);
- any entity organized under the laws of the United States or any jurisdiction within the United States, including any foreign branch of any such entity; and
- any person located in the United States.

The Outbound Investment Rule also imposes requirements on a U.S. person with respect to any “controlled foreign entity” to which it is a “parent” (meaning directly or indirectly controlling a majority of the voting interest, acting as the general partner or managing member, or acting as an investment adviser to a pooled investment fund).⁵ U.S. persons would be required to (1) take “all reasonable steps to prohibit and prevent” the controlled foreign entity from conducting a transaction that would be prohibited for a U.S. person and (2) notify Treasury of any notifiable transactions undertaken by the controlled foreign entity. “All reasonable steps” can include both the affirmative exercise of governance rights and the imposition of compliance policies and internal controls on a controlled entity.⁶ Effectively, foreign subsidiaries of U.S. entities are also required to comply with the Outbound Investment Rule, where the U.S. parent has the ability to control the activities of the subsidiary.

The applicability of the Outbound Investment Rule to individual U.S. persons who may have executive positions with non-U.S. companies (or to non-controlling U.S. investors) is essentially a recusal regime. The Outbound Investment Rule prohibits a U.S. person from “knowingly directing” a non-U.S. person to engage in a transaction prohibited for a U.S. person (whether or not it is a controlled foreign entity). “Knowingly directing” includes having the authority “to make or substantially participate in decisions on behalf of a non-U.S. person” and exercising that authority “to direct, order, decide upon, or approve a transaction,” including as part of a collective decision. Authority is presumed if the U.S. person is an officer, director, or otherwise possesses senior-level authority to approve or disapprove a transaction,⁷ but exercise of that authority is still required. U.S. persons can avoid participation by recusing themselves from decision-making regarding approval or recommendation of a transaction, commenting on transaction documents, or negotiating with a transaction counterparty. Following comments on the NPRM, Treasury clarified that neither routine business activities in support of a transaction decided by others nor post-transaction integration activities constitute prohibited activities. There is no general “facilitation” prohibition, nor is there a broad prohibition on conducting transactions within U.S. jurisdiction, as would be the case under OFAC sanctions.

Which investments are covered?

The Outbound Investment Rule primarily targets equity investments, but the scope of the rule’s definitions are broad and have important (though, in the final rule, moderated) implications for transactions involving Chinese companies engaged in covered activities. Most importantly, initial indications that indirect investments in Chinese companies through foreign-managed funds would be exempted have been reversed in the final Outbound Investment Rule, and U.S. institutional investors are essentially prohibited from investing in foreign funds that do not agree to avoid covered investments.

Equity

In the simplest case, the Outbound Investment Rule covers an acquisition of an equity interest in a covered foreign person. There is no exception for follow-on investments.

The primary exceptions are for equity that is publicly traded (in any market) and any equity issued by an “investment company” under the Investment Company Act of 1940 that is registered with the Securities and Exchange Commission. However, in order to be eligible for the exception, the U.S. person may not acquire affirmative or blocking rights of any kind other than standard minority protections, explicitly including the right to make a shareholder proposal, which Treasury noted could be as low as 3% under PRC law. This may set a very low cap on a U.S. person’s shareholding; it also remains unclear how Treasury will treat jurisdictions (e.g., Delaware) where the requirements for submission of a shareholder proposal are *de minimis*.

In response to comments on the NPRM, Treasury also explicitly excluded equity-based awards for U.S. person individuals associated with foreign investors or covered companies, such as stock options or carried interest. Derivatives are also excluded, so long as they do not provide governance rights or the rights to acquire equity or assets of the issuer. Finally, the Outbound Investment Rule also excepts acquisitions of all equity held by persons of a country of concern, so long as the target entity thereafter no longer constitutes a covered foreign person (but not less than all such equity, even if as a result persons of a country of concern would be reduced to a minority), and investments by U.S. persons in their own controlled foreign entities that support ongoing activities not targeted by the Outbound Investment Rule.

IPOs

The Outbound Investment Rule explicitly takes the view that acquisitions of non-publicly traded equity are covered even if the purpose of the acquisition is to support an IPO (e.g., by a U.S. or U.S.-controlled underwriter). Other IPO-related services are still permitted, but U.S. entities and their controlled subsidiaries can only acquire equity in a covered company once it is publicly traded.

Contingent equity instruments

Instruments convertible to equity (e.g., options, warrants, or convertible loans) are assessed both at the time of the acquisition of the instrument and at the time of conversion, so that conversion can be notifiable or prohibited even if at the time of the acquisition the company was not engaged in covered activities (and the original acquisition must also be notified or avoided if the U.S. acquiror has knowledge that the target is a covered foreign company). Conversion of contingent interests acquired before the effective date of the rule is exempted.

Debt

Debt transactions are not, standing alone, covered transactions, unless the debt is by its terms convertible to equity or provides equity-like rights such as a profits interest or the right to appoint board members.

However, even pure debt transactions may give rise to a covered transaction if they result in the acquisition of equity, such as where the lender executes upon collateral including equity of a covered foreign person or debt is converted to equity in an insolvency proceeding, or when a creditor receives the right to appoint a board member in a distressed company. In other words, traditional debt enforcement mechanisms could be impaired where the borrower is a covered foreign company. For the rule to apply, the lender must have “knowledge” that the borrower is a covered foreign company both at the time of conversion and at the time that the lender acquires the debt (either at issuance or on the secondary market); thus, unlike contingent equity interests, a change in the company’s activities does not affect the ability to execute on collateral. As with contingent equity interests, though, execution on equity collateral pledged prior to the effective date of the Outbound Investment Rule is exempt from coverage.

A further exception is provided for acquisitions upon default where U.S. lenders are loan syndicate participants that do not have a lead role and cannot themselves initiate action.

Asset acquisitions

The Outbound Investment Rule targets the establishment of new ventures (or the expansion of existing ventures) in China by including as a covered transaction the “acquisition, leasing, or other development of operations, land, property, or other assets” if the U.S. person knows or plans they will be used to establish a new “covered foreign person” or permit a Chinese entity to embark on new covered activities. This appears to be aimed at investments through affiliates that might not result in new equity interests.

Joint ventures

The Outbound Investment Rule’s definition of a covered investment would also include a U.S. person’s “entrance into a joint venture, wherever located, that is formed with a person of a country of concern” if the U.S. person “knows” that the joint venture will engage in or plans to engage in a covered activity. “Joint venture,” however, is left undefined and the scope of the provision is not entirely clear. Treasury has indicated that the term is not intended to capture ordinary commercial relationships, but rather circumstances where each party contributes capital or assets and shares in profits or losses of a joint venture that engages, or plans to engage, in covered activity. Less clear is how significant the stake of a person of a country of concern must be (for example, a supplier that takes a minority investment in its customer).

Investment funds and other indirect investments

The final Outbound Investment Rule effectively eliminates the previously proposed exemption for institutional investors making a passive investment in a pooled investment vehicle (other than an investment company registered with the SEC), limiting the exemption to two million dollars. Assuming that the investment is a typical LP interest with no governance rights, LP investments in a non-U.S. pooled investment fund are covered where (1) the U.S. person LP knows at the time of the investment that the fund is “likely” to invest in the relevant industries in China, and (2) the pooled investment in fact undertakes a transaction that would be a covered transaction if conducted by a U.S. person. Meeting

binding capital commitments entered into prior to the effective date of the Outbound Investment Rule is exempted. U.S. persons may also invest in funds that invest in notifiable or prohibited transactions without complying with the Outbound Investment Rule's requirements if they obtain binding contractual commitments that their capital will not be used in the covered investments (e.g., via a "side pocket" or similar arrangement).

Furthermore, the Outbound Investment Rule would apply to "indirect covered transactions" (other than pooled investment funds), meaning that a transaction would be a covered transaction

"regardless of the number of intermediary entities involved in such transaction." While there are some obvious cases (such as the example given in the Outbound Investment Rule where a U.S. person makes an investment through a non-U.S. special purpose vehicle), as noted above, the implications may be more far-reaching for investments in large entities that may arguably have covered activities in an immaterial subsidiary. The rule does not, however, cover investments in non-U.S. companies that subsequently invest in covered foreign companies, assuming the later transaction is unrelated and not intended to evade the Outbound Investment Rule.

"Knowledge": the elephant in the room

The definition of "knowledge" in the NPRM attracted extensive comment. The definition of "knowledge" not only includes **actual knowledge** that a fact or circumstance exists or is substantially certain to occur, but also an **awareness of a high probability** of a fact or circumstance's existence or future occurrence, or **reason to know** of a fact or circumstance's existence. In assessing whether a U.S. person had reason to know of a fact or circumstance's existence at the time of the transaction, Treasury will not rely solely on subjective knowledge or expectation but also whether the investor conducted a "reasonable and diligent inquiry."

Treasury has indicated that it will consider the following factors, among others, in determining whether a reasonable and diligent inquiry was conducted:

- Diligence inquiries made of the target or counterparty by the investor or its counsel;
- Contractual representations or warranties obtained or sought relating to whether a counterparty is a covered foreign person and whether a transaction is a covered transaction;
- Efforts made to obtain and review available non-public information relevant to determine whether a counterparty is a covered foreign person and a transaction is a covered transaction;
- Use of public and commercial databases to identify and verify relevant information of an investment target or relevant counterparty;
- Available public information at the time of the transaction, efforts by the U.S. person to review such information, and the degree to which such information is consistent or inconsistent with other information available to the U.S. person;
- The presence or absence of warning signs (which may include evasive responses or non-responses from an investment target or refusal to make certain representations and warranties) and any purposeful avoidance of learning or sharing information by the U.S. person; and
- In the context of LP investments, where knowledge of what a fund is "likely" to do is relevant, facts such as the fund's investment history or geographies and sectors of focus.

For certain categories of covered transactions, "intent" is also relevant but undefined. The issue here is less a question of the dictionary definition of the word than of whose intent is relevant and how the investor is meant to assess the intent of others. Many of the prohibited and notifiable activity categories turn on the "intended" end use or end users, which is not specifically a question of the investor's intent and can be very difficult to determine in an early-stage company.

Because the Outbound Investment Rule has no pre-clearance process and is solely an enforcement-based regime, "knowledge" will be assessed after the fact and, as a practical matter, with the benefit of hindsight, by government officials of uncertain commercial experience. Multiple commenters argued that certain of the steps outlined above may be unfeasible in particular circumstances and that the standard does not give U.S. investors legal certainty. Treasury responded to the comments by giving itself discretion to consider all the facts and circumstances in the post-facto determination of whether the U.S. person conducted "reasonable and diligent inquiry," which seems unlikely to provide the desired certainty to investors.

What does compliance entail?

Prohibitions

The outbound investment program will be managed by Treasury's Office of Investment Security, which is also responsible for managing the review process of the Committee on Foreign Investment in the United States (CFIUS). Unlike the CFIUS process, however, the Outbound Investment Rule does not establish a process for a case-by-case review and clearance of transactions. Instead, the prohibitions of the regulations are self-executing and there is no review or advisory mechanism. U.S. investors are responsible for determining whether an investment is prohibited and should proceed at their own risk.

Notifications

Where notification is required, U.S. persons must submit notifications (including notifications relating to foreign entities they control) electronically to Treasury no later than 30 days after the completion date⁸ of the covered transaction.⁹ The Outbound Investment Rule sets out the information required to be submitted in a notification, which includes, among other things, a description of the U.S. person, a description of the transaction (including the commercial rationale for the transaction), information about the covered foreign person (including an organization chart, ultimate ownership, and the full legal name and title of each officer, director, and other member of management), and an explanation of why the transaction is a covered transaction. If a U.S. person cannot provide any of the information required for a notification, the filer must explain why not and describe the efforts made to obtain the missing information.

After the U.S. person files the notification, Treasury may follow up with the U.S. person with requests for additional information or documents. The U.S. person would be required to respond to any follow-up questions and requests within the time frame and in the manner determined by Treasury. The filing party must maintain copies of the notification (and any supporting documentation) for 10 years after the date of the filing.¹⁰ Non-public information submitted in connection with the notification is confidential, except as disclosed to courts, Congress, or other domestic or foreign governmental entities under appropriate classification or confidentiality arrangements.

The individual submitting the information must be an authorized officer of the investor and must certify that the notification and other information provided fully complies with the Outbound Investment Rule and is accurate and complete in all material respects to the best knowledge of the individual.¹¹ While this individual certification requirement is patterned on CFIUS filings, in this case (a) it applies to information regarding the target company that is not within the direct control of the investing entity and (b) it would seem to apply the same broad definition of "knowledge" to the individual certification that applies more generally under the rule (i.e., it is not limited to actual knowledge).

Ongoing monitoring requirements and recordkeeping

Compliance obligations do not end when the investment is completed. If, following an investment, a U.S. person obtains actual knowledge of facts that would have made the investment prohibited or notifiable under the Outbound Investment Rule had the investor known them at the time of the investment, the U.S. person must file a notification within 30 days, providing all relevant information, an explanation of why the information was not available to the U.S. person at the time of the transaction, and a description of the pre-transaction diligence conducted by the investor. Similarly, any person making any representation, statement, or certification to Treasury in connection with a notification has an affirmative obligation to notify Treasury within 30 days if that person becomes aware of any material omission or inaccuracy.

The requirements do not, on their face, apply to post-investment changes in the activities of a company. As a practical matter, though, such changes may raise questions as to whether the transaction should have been identified as notifiable or prohibited at the time it was entered into because of planned future activities; at a minimum, investors will want to identify and analyze activities of portfolio companies that may be relevant under the Outbound Investment Rule on an ongoing basis.

The Outbound Investment Rule also provides a process for U.S. persons to submit voluntary self-disclosures to Treasury if they believe they have violated any requirement under the Outbound Investment Rule, consistent with the approach taken by a range of similar agencies. Voluntary self-disclosures will be taken into consideration when Treasury assesses the appropriate enforcement response to violations of the Outbound Investment Rule.

Investors are required to retain supporting documentation for a notifiable transaction for ten years; while this does not explicitly apply to diligence materials where no notification is filed, it is also the statute of limitations under the International Emergency Economic Powers Act (the statutory authority for the Outbound Investment Rule), and so as a practical matter it is advisable to retain diligence materials for potentially covered transactions for that period.

National interest exemptions

There is a possibility to request a national interest exemption from either the prohibition or notification requirements applicable to covered transactions. However, Treasury has indicated that it expects that such exemptions will only rarely be granted, and the national interest exemption process is not the equivalent of a licensing procedure. The U.S. person seeking the exemption (on its own behalf or on behalf of a controlled foreign entity) is required to submit to Treasury information about the covered transaction, including a description of the scope of the covered transaction, the basis for the exemption request, and an analysis of the covered transaction's potential impact on the U.S. national interest.

Penalties

The following would be violations of the Outbound Investment Rule:

1. Taking any action prohibited by the Outbound Investment Rule;
2. Failing to take any action required by the Outbound Investment Rule within the time frame and in the manner specified;
3. Making materially false or misleading representations to Treasury in a notification; and
4. Evading or avoiding any of the prohibitions of the Outbound Investment Rule.

Violations of the Outbound Investment Rule would be subject to the penalties provided in section 206 of the International Emergency Economic Powers Act (IEEPA). Civil penalties could include a monetary penalty of up to twice the value of the underlying transaction (or, if greater, approximately \$360,000). Treasury would also have authority to order the nullification or force the divestment of any prohibited investment. In the case of willful violations, criminal penalties of up to 20 years' imprisonment and a fine of up to \$1 million are possible.

As noted in our previous client update, while the substantive prohibitions of the Outbound Investment Rule apply to U.S. persons, IEEPA provides for liability for any person who conspires to violate or causes a violation of the statute or any regulation issued thereunder (which would include the Outbound Investment Rule), which could provide a basis for liability for non-U.S. persons involved in a prohibited investment by a U.S. person.

Next steps

Given the Outbound Investment Rule's focus on "reasonable and diligent inquiry" to identify potentially covered transactions, we expect the M&A market to evolve rapidly where investments in potentially covered companies (including both Chinese companies and companies in the relevant industries with activities in China) are involved. Additional representations and covenants are likely to be requested by investors and lenders, but Treasury has made clear that it does not consider contractual provisions, standing alone, to be sufficient. Diligence requests are also likely to expand, and Treasury's expectations for use of external resources and retention of detailed records of diligence for long periods of time, in particular, may require changes to existing M&A processes. In financing markets, substantial additional diligence beyond current market practice may be required for U.S. lenders to be confident that they will be able to execute on equity collateral or participate in a future restructuring. Treasury has indicated that it intends to post frequently asked questions and other guidance on the Outbound Investment Security Program website, available [here](#); this may provide further clarity as the program is implemented.

We also expect that the outbound investment rules will continue to evolve. Treasury has noted that the notification requirements are in part designed to inform future evolution of the rules and that new technologies of concern may be added over time. Furthermore, Congress has from time to time proposed legislative action to expand outbound investment controls that has focused on additional sectors, such as biotechnology. While we do not expect expansion in the short term given the work required in both the government and private sectors to implement the new regime, over the medium term further evolution is possible.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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- ¹ More precisely, the standard would be met where a person of a country of concern holds 50% or more of an entity's outstanding voting interests, voting power of the board, or equity interests.
- ² Investments held by a non-Chinese entity that if held by a U.S. person would be covered by the exception in 31 CFR § 850.501(a) of the rule—such as publicly traded securities—would not be equity or voting interests that result in a non-Chinese entity being deemed a covered foreign person.
- ³ The restrictions also apply to OFAC's Specially Designated Nationals (SDNs) and entities designated by the State Department as foreign terrorist organizations, which typically are also SDNs, but are redundant given that substantially all transactions by U.S. persons with such entities are already prohibited.
- ⁴ The full definition is "to engage in any stages prior to serial production, such as design or substantive modification, design research, design analyses, design concepts, assembly and testing of prototypes, pilot production schemes, design data, process of transforming design data into a product, configuration design, integration design, and layouts." 31 CFR § 850.211.
- ⁵ The Outbound Investment Rule provides attribution rules for indirect investments, essentially attributing up to 100% of any voting interests held by controlled entities and a pro rata allocation of voting interests held by non-controlled entities.

- ⁶ Under the Outbound Investment Rule, Treasury would consider, among other things, the execution of compliance agreements, periodic training, and the implementation and testing of internal controls.
- ⁷ Treasury clarified, however, that a person would not be deemed to “knowingly direct” a transaction merely through “the provision of third-party services such as banking services” or for “routine administrative work by a U.S. person who lacks substantial involvement in an investment decision.”
- ⁸ The Outbound Investment Rule would define the completion date as the earliest date upon which any interest, asset, property, or right is conveyed, assigned, delivered, or otherwise transferred to a U.S. person, or as applicable, its controlled foreign entity or applicable fund.
- ⁹ If a U.S. person files a notification prior to the completion date, the U.S. person is required to update the notification no later than 30 days after completion date if any information in the notification has materially changed.
- ¹⁰ Supporting documentation includes pitch decks, marketing letters, offering memorandums, transaction documents (including side letters and investment agreements), and due diligence materials related to the transaction.
- ¹¹ Certifications by the U.S. person include a statement that all information provided to Treasury in the notification (1) fully complies with the applicable regulations and (2) is accurate and complete in all material respects (to the knowledge of the U.S. person). Certifications can be signed by the filing party’s chief executive officer and any authorized designee, which would include a general partner and any officer of a corporation.

Appendix A

Covered National Security Technologies or Products:

Semiconductors and microelectronics

Activities implicating investment prohibition:

- Develops or produces any electronic design automation software for the design of integrated circuits or advanced packaging.
 - Develop is defined under the Outbound Investment Rule as engaging in any stages prior to serial production.
 - Advanced packaging is defined under the Outbound Investment Rule as packaging integrated circuits in a manner that supports the two-and-one-half-dimensional (2.5D) or three-dimensional (3D) assembly of integrated circuits, such as by directly attaching one or more die or wafer using through-silicon vias, die or wafer bonding, heterogeneous integration, or other advanced methods and materials.
- Develops or produces any front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits, equipment for performing volume advanced packaging or commodity, material, software, or technology designed exclusively for use in or with extreme ultraviolet lithography fabrication equipment.
- Designs any integrated circuit that meets or exceeds the performance parameters in Export Control Classification Number 3A090.a or is designed for operation at or below 4.5 Kelvin.
- Fabricates (i.e., forms devices such as transistors, poly capacitors, non-metal resistors, and diodes on a wafer of semiconductor material) any integrated circuit that is a:
 - logic integrated circuit using a non-planar transistor architecture or with a production technology node of 16/14 nanometers or less, including a fully depleted silicon-on-insulator (FDSOI) integrated circuit;
 - NOT-AND (NAND) memory integrated circuit with 128 layers or more;
 - dynamic random-access memory (DRAM) integrated circuit using a technology node of 18 nanometer half-pitch or less;
 - integrated circuit manufactured from a gallium-based compound semiconductor;
 - integrated circuit using graphene transistors or carbon nanotubes; or
 - integrated circuit designed for operation at or below 4.5 Kelvin.
- Packages any integrated circuit using advanced packaging techniques.
 - Advanced packaging is defined under the Outbound Investment Rule as packaging integrated circuits in a manner that supports the two-and-one-half-dimensional (2.5D) or three-dimensional (3D) assembly of integrated circuits,

such as by directly attaching one or more die or wafer using through-silicon vias, die or wafer bonding, heterogeneous integration, or other advanced methods and materials.

- Develops, installs, sells, or produces any supercomputer 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 41,600 cubic foot or smaller envelope.

Activities implicating notification requirement:

- Designs any integrated circuit other than certain high-performance integrated circuits discussed in the third activity above.
- Fabricates any integrated circuit other than certain specified integrated circuits discussed in the fourth activity above.
- Packages any integrated circuit other than through advanced packaging techniques discussed in the fifth activity above.
 - Package is defined under the Outbound Investment Rule as assembling various components, such as the integrated circuit die, lead frames, interconnects, and substrate materials to safeguard the semiconductor device and provide electrical connections between different parts of the die.

Quantum information technologies

Activities implicating investment prohibition:

- Develops a quantum computer or produces any of the critical components required to produce a quantum computer such as a dilution refrigerator or two-stage pulse tube cryocooler.
 - Quantum computer is defined under the Outbound Investment Rule as a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference, or entanglement.
- Develops or produces any quantum sensing platform designed for, or which the relevant covered foreign person intends to be used for, any military, government intelligence, or mass-surveillance end use.
- Develops or produces any quantum network or quantum communication system designed for, or which the relevant covered foreign person intends to be used for:
 - networking to scale up the capabilities of quantum computers, such as for the purposes of breaking or compromising encryption;
 - secure communications, such as quantum key distribution; or
 - any other application that has any military, government intelligence, or mass-surveillance end use.

Artificial intelligence

Activities implicating investment prohibition:

- Develops any AI system that is designed to be exclusively used for, or which the relevant covered foreign person intends to be used for, any:
 - military end use (e.g., for weapons targeting, target identification, combat simulation, military vehicle or weapon control, military decision-making, weapons design, or combat system logistics and maintenance); or
 - government intelligence or mass surveillance end use (e.g., through mining text, audio, or video; image recognition; location tracking; or surreptitious listening devices).
- Develops any AI system that is trained using a quantity of computing power greater than 10^{24} computational operations (e.g., integer or floating-point operations) if trained using primarily biological sequence data or 10^{25} computational operations otherwise.

Activities implicating notification requirement:

- Develops any AI system (other than those that implicate the investment prohibition, see above) that either:
 - meets certain end-use requirements, namely that the system is designed for government intelligence, mass surveillance, or military end use;
 - is intended by the person of a country of concern to be used for cybersecurity applications, digital forensics tools, and penetration testing tools, or the control of robotic systems; or

- was trained using computing power greater than 10^{23} computational operations (e.g., integer or floating-point operations).