US outbound screening rules narrower than feared

Sectors highly targeted, but greenfield FDI caught by White House's 'reverse-CFIUS' plan

Making history: US president Joe Biden (right) has announced the world's first outbound investment screening regime, but left it to Treasury secretary Janet Yellen (left) to decide the finer details. Image via Getty

Danielle Myles August 17, 2023

The US's long-awaited outbound investment screening regime is narrower than many had feared, but finer details defining which deals are captured by the first-of-its-kind framework are yet to be thrashed out.

On August 9, US president Joe Biden issued an executive order that limits US investment in China's semiconductor, quantum computing and artificial intelligence (AI) sectors that pose national security risks. It follows more than five years of debate in Washington DC over how to stop US capital and know-how from advancing dual-use technology in China.

In the months leading up to the announcement, the rumoured executive order had stoked fears it would hit US competitiveness by imposing far-reaching rules and limitations on investing in the world's second-biggest economy. However the White House's policy has helped alleviate some concerns over unintended consequences stemming from the world's first outbound investment screening regime.

"The executive order is narrower than many had expected," says John

Beahn, partner at law firm Milbank in Washington DC. “[It] does not outright prohibit any investments out of the gate.” While some had anticipated sector-wide bans or prohibitions on broad sets of products, Mr Beahn notes that the White House has taken a “more discrete approach”.

The regime captures sensitive technologies and products within the semiconductors and microelectronics, quantum information technologies, and AI industries that are ‘critical for [China’s] military, intelligence, surveillance, or cyber- enabled capabilities. In the executive order, Mr Biden describes US investment in these areas as a “national emergency”.

Nonetheless, Nancy McLernon, president and CEO of the Global Business Alliance, says the policy’s focus on three specific industries makes it “clear that the administration sought to balance economic competitiveness with safeguarding national security interests”.

Harry Broadman, managing director at the Berkeley Research Group, describes the executive order as less “heavy-handed” than other policy options at the White House’s disposal, such as extending the country’s existing investment screening rules to encompass outbound deals.

“It reflects the bind the administration found itself due to some US businesses expressing anxiety about losing investment market share in China to G7 rival firms,” says Mr Broadman, who is a former member of the the US’s Committee on Foreign Investment in the United States (CFIUS), which scrutinises inbound investments.

Short on specifics

While the executive order lays the foundation for the so-called ‘reverse CFIUS’ regime, Mr Beahn notes that it is “very short on specifics”. The heavy lifting has been left to the Treasury department, which must promulgate rules identifying which outbound transactions must be notified to the government and which will be prohibited.

On the same day that the executive order was released, the Treasury issued the regime’s draft rules and started a 45-day public consultation period — a process Ms McLernon says "presents a robust opportunity for stakeholders to respond and weigh in".

Yet while the government promises to take a narrow approach to covered sectors, it is casting a wide net in terms of the types of investments captured. The Treasury anticipates the rules will cover mergers and acquisitions, private equity, venture capital, joint ventures, debt financing convertible into equity, and greenfield investments that could lead to the establishment of sensitive technologies and products caught by the rules.

Mario Mancuso, head of law firm Kirkland & Ellis's international trade and national security practice, notes that the rules will also apply to investments made through offshore vehicles. "There is some considerable effort to constrain US … investors from using alternative corporate structures to avoid the new legal regime," he says.

It is not clear when the framework will take effect, but Mr Beahn says the fact draft regulations were issued alongside the executive order suggests the government "wants to move relatively quickly". Based on previous US rulemaking, he expects the outbound rules to be in place by early 2024. Around that time, the EU is expected to have proposed its own outbound screening initiative.