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Via regulations.gov (Docket ID TREAS-DO-2023-0009)

Meena R. Sharma
Acting Director
Office of Investment Security Policy and International Relations
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: <u>Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern</u>

Dear Ms. Sharma:

SIFMA appreciates the opportunity to comment on the advance notice of proposed rulemaking ("ANPRM") regarding the Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern published on August 14, 2023, by the Department of the Treasury's Office of Investment Security (the "Proposed Rule") to implement Executive Order 14105 of August 9, 2023, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (the "EO").

SIFMA recognizes the important role that the Department of the Treasury ("Treasury") plays in protecting U.S. national security and appreciates Treasury's efforts to ensure that the Proposed Rule targets investments that implicate the national security concerns described in the EO, without unnecessarily impairing beneficial business activity that otherwise advances U.S. national security and economic interests. In that regard, SIFMA offers comments focused on clarifying the scope of the Proposed Rule, especially as it relates to the U.S. financial services industry and its role in supporting the U.S. economy.

As the EO notes, open capital flows "create valuable economic opportunities and promote competitiveness, innovation, and productivity." The U.S. financial services industry facilitates this flow of capital, accounting for 10 percent of U.S. gross domestic product. U.S. capital markets fund over 70 percent of all economic activity in the United States and account for 41 percent of all global equity and 40 percent of global fixed income. To preserve the United States' economic leadership, including the continued use of the U.S. dollar as the global reserve currency, it is critical that the Proposed Rule set out clear and easily applied rules, so as not to introduce uncertainty into a multi-trillion-dollar industry that is a cornerstone of U.S. global competitiveness. To do so would imperil U.S. economic and national security interests, contrary to the purpose of the EO that the Proposed Rule would implement.

As explained more fully below, SIFMA respectfully requests that Treasury consider the following actions as part of the rulemaking process for implementing the EO:

1. Clarify that the obligation to comply with the EO applies only to the entity or individual undertaking the covered transaction (the "Covered Investor"), and not to other parties involved in or tangential to the transaction. In particular, clarify that the scope of

"covered transactions" does not include services provided by financial institutions to their customers in respect of covered transactions.

2. Revise the definition of "covered foreign person" to create a standard that can be readily ascertained and applied, and that does not sweep in entities undertaking a *de minimis* level of activity related to covered national security technologies and products.

3. Provide guidance regarding the "knowledge" standard and the level of due diligence parties are expected to undertake in order to comply with the EO.

4. Issue guidance on enforcement and civil money penalties, including the principles that Treasury will apply in considering whether to impose penalties and in what amount, and when Treasury would refer matters to the Department of Justice.

5. Implement certain other clarifications and changes discussed further in this letter.

SIFMA appreciates Treasury's consideration of the following comments and looks forward to further exchanges regarding how to implement the EO while preserving the United States' commitment to open and rules-based cross-border investment.

1. Clarify that the obligation to comply with the EO applies only to the Covered Investor

Treasury proposes in the ANPRM to prohibit or require a notification for a "covered transaction," meaning "a U.S. person's direct or indirect (1) acquisition of an equity interest or contingent equity interest in a covered foreign person; (2) provision of debt financing to a covered foreign person where such debt financing is convertible to an equity interest; (3) greenfield investment that could result in the establishment of a covered foreign person; or (4) establishment of a joint venture, wherever located, that is formed with a covered foreign person or could result in the establishment of a covered foreign person."

We agree with Treasury's intended approach to exclude from the coverage of the EO services that are secondary to a covered transaction. The final rule thus should make clear that the obligation to comply with any prohibition or notification requirement under the EO – and liability for non-compliance therewith – reside solely with the Covered Investor – i.e., the entity or individual undertaking the covered transaction. The obligation should not extend to other parties involved in the transaction, such as the person selling an equity interest or a third party otherwise involved in the transaction, for example, as an advisor, underwriter, source of debt financing, sponsor, arranger, issuer, or in any other capacity as a U.S. financial institution acting in an intermediary or other capacity.

Imposing obligations on third parties who are involved in but not undertaking the covered transaction would greatly complicate the U.S. government's ability to implement and enforce the EO and harm U.S. industry without advancing any national security objectives. Determining whether a transaction is a "covered transaction" under the EO will be a highly technical analysis, requiring an assessment of the nature of business activities that in most cases occur in a foreign country. This information will be obtainable only from the covered foreign person, and in most cases only the Covered Investor will be in a position – legally or practically – to obtain the necessary information from the covered foreign person. In this regard, Treasury should consider the possibility of potential conflicts of law from other jurisdictions that may place restrictions on the export of data from China and create other challenges in obtaining research on investment

targets in China, including with respect to the makeup of a Chinese company's revenue, income, capital expenditure, and operating expenses, including how much is contributed by each subsidiary and branch, and whether any subsidiary or branch is engaged in any identified activities with respect to covered national security products or technologies.

Third parties such as financial institutions in particular may not have access to the information necessary to determine whether a particular transaction is a covered transaction, and if so, whether it would be prohibited or subject to a notification requirement. Moreover, even if a third party determines that a notification is required, the third party may not have the information required for a complete notification. Such notifications also would be redundant, given that the Covered Investor would be obligated to comply with the EO, and would have the greatest access to information required to provide a complete and useful notice to Treasury.

Moreover, financial institutions may decide that it is too risky from a compliance standpoint to offer their services to clients that are engaged in beneficial and non-sensitive businesses involving semiconductors, quantum technologies, or artificial intelligence ("AI"), or to clients that may be engaged in different industry sectors, but that undertake *de minimis* levels of activity related to semiconductors, quantum technologies, or AI. This could include clients both in the United States and in the rest of the world outside of China, given the potentially broad definition of "covered foreign persons." Non-U.S. financial institutions likewise may elect not to hire U.S. persons in decision making roles abroad to avoid the additional compliance burden under the EO, which would reduce the ability of foreign institutions to benefit from U.S. expertise and relationships to the detriment of U.S. interests.

For the same reasons, the final rule should clarify that U.S. persons "knowingly directing transactions if such transactions would be prohibited [by the EO] if engaged in by a United States person" refers only to the situation in which a U.S. person has the authority to make decisions on behalf of the non-U.S. entity, either as a result of an ownership interest, rights conferred under the organizational documents, or authority that is delegated under the corporate organizational documents or corporate policies, and exercises that authority with respect to the transaction in question. The scope of "directing" should not include intermediaries or third parties such as financial institutions that merely facilitate a transaction, persons acting in supporting roles to carry out a transaction, or persons acting in an administrative or ministerial capacity.

The approach we propose is consistent with Treasury's intent as reflected in the ANPRM, which provides that "the policy intent of this program is not to implicate [bank lending, the processing, clearing, or sending of payments by a bank, underwriting services, debt rating services, prime brokerage, global custody, equity research and analysis, and 'other services secondary to a transaction'] unless undertaken as part of an effort to evade these rules." While we understand that Treasury intends not to target these types of transactions, it is critical that the final rule unambiguously exempt these transactions in order to provide the financial services industry with legal certainty and to avoid unintended consequences to the detriment of the broader economy and U.S. policy objectives.

In this regard, we note that Treasury indicates in a different part of the ANPRM that it "does not intend for the definition of 'covered transaction' under consideration to apply to [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], *so long as they do not involve any of the definitional elements of a 'covered transaction'* and are not undertaken as part of an effort to evade these rules" (emphasis added). SIFMA supports codifying these exemptions, but, contrary to Treasury's stated intent,

the italicized text introduces ambiguity about whether any secondary transactions – such as those undertaken by financial institutions – in fact would be excluded from the scope of the EO.

Consider, for example, a scenario in which a U.S. financial institution is underwriting an issuance of equity. Because underwriting an issuance of equity involves the U.S. financial institution acquiring such equity from its client before selling it, the financial institution would be required to determine whether its client is a covered foreign person, even if its client is incorporated in the United States or otherwise outside of China, because it could be Chinese-owned or derive more than 50 percent of its revenue from covered foreign person subsidiaries. If the U.S. financial institution's client is a covered foreign person, the financial institution would be subject to a prohibition or a notification requirement because the underwriting transaction would meet the definition of a covered transaction (i.e., the acquisition of equity by a U.S. person from a covered foreign person).

We understand that Treasury is focused on primary investment transactions by U.S. persons, not secondary transactions and other services provided by third party financial institutions that may facilitate covered transactions or involve financial products related to a covered transaction. Accordingly, we recommend that Treasury make explicit that transactions undertaken by financial institutions that are not the primary investment in the covered foreign person are excepted from the scope of the EO, regardless of whether they meet the definition of a covered transaction. In the alternative to such an exception, we recommend that Treasury make explicit that the following specific types of transactions constitute "excepted transactions":

- Processing, settling, clearing, or sending of payments, and any other functions necessary for proper functioning of existing markets by any entity (both banks and non-bank entities), including cash transactions such as opening bank accounts and facilitating payments pursuant to client instructions, direct custody services, foreign exchange services, and passive holding services;

- Any transaction in which a bank or other financial services provider would acquire equity or collateral for a limited period of time, such as prime brokerage, underwriting (including acting as initial purchaser in a Rule 144A transaction), market making, sponsoring or supporting a company to issue American depository receipts or global depository receipts, and as part of a foreclosure process;

- All lending activities by banks and non-bank entities, including trade financing, factoring, and loan guarantees;

- Acting as a trustee, investment manager, or paying agent for a non-U.S. fund;

- Mergers and acquisitions ("M&A") advisory services, and agency and trust services associated with M&A;

- The issuance and trading of instruments and other products that may be transacted on an over-the-counter or on an exchange-traded or centrally-cleared basis, including, but not limited to, derivatives, swaps (such as credit default swaps and total return swaps), forwards, options, and any other product traded under a master agreement or other similar agreement governing such transactions (e.g., ISDA Master Agreement, Master Securities Forward Transaction Agreement, Customer Clearing Agreement, together with Cleared OTC Derivatives Addendum thereto, or Global/Master Repurchase Agreement), or any structured, equity- or credit-linked note that has

substantially the same effect as a derivative (issued by a person that is not a Covered Foreign Person); and

- Leasing of real property and the provision of software as a service, infrastructure as a service, and other "as a service" business models.

Absent an explicit, categorical exception for transactions undertaken by financial institutions that are not the primary investment in the covered foreign person, regardless of whether they meet the definition of a covered transaction, it will be important that the transactions identified above are enumerated explicitly in the final rule as "excepted transactions" to provide U.S. financial institutions and their clients with certainty that these types of transactions are not prohibited or subject to a notification requirement under the EO. Excluding these types of transactions from the scope of "covered transactions" simply by omitting them from the definition of "covered transactions," or indicating that Treasury does not intend for the definition to apply to these types of activities "so long as they do not involve any of the definitional elements of a 'covered transaction,'" does not provide sufficient clarity to avoid broader chilling effects on beneficial economic activity. That approach may lead financial institutions to determine that they are required to assess in every circumstance whether a transaction of the types described above could constitute a "covered transaction," which would increase the complexity of compliance, and increase costs astronomically for financial institutions that may undertake millions of these types of transactions every day, with no corresponding policy benefit.

Similarly, Treasury should clarify that the EO would not apply to debt financing secured by equity. Treasury proposes to define "covered transaction" in relevant part to mean "a U.S. person's direct or indirect . . . provision of debt financing to a covered foreign person where such debt financing is convertible to an equity interest." However, a significant portion of debt financing is secured by equity in the debtor. While we understand that Treasury does not intend to cover bank lending, unless the final rule expressly exempts debt financing secured by equity, the intended coverage of "convertible debt" may create confusion about the scope of that term.

In this regard, we recommend that debt be treated essentially the same way as it is treated under the regulations governing the Committee on Foreign Investment in the United States ("CFIUS") – i.e., the extension of a loan or a similar financing arrangement by a U.S. person to a covered foreign person, regardless of whether accompanied by the creation in favor of the U.S. person of a secured interest over securities or other assets of the covered foreign person, should not, by itself, constitute a covered transaction. *See* 31 C.F.R. § 800.306. In the case of such financing, the EO should apply only when the financing is accompanied by financial or governance rights characteristic of an equity investment but not of a typical loan, such as an interest in profits of the covered foreign person or the right to appoint members of the board of directors of the covered foreign person. Further, the acquisition of equity of a covered foreign person by a lender through a foreclosure process or otherwise as the result of a non-performing loan should be made an "excepted transaction" under the final rule, as the acquisition of equity under such circumstances would not involve the same 'intangible benefits' as the acquisition of equity through a private equity or venture capital investment.

In addition to the foregoing, Treasury should clarify in the final rule how the EO would apply to other types of instruments that are convertible into equity, such as warrants, convertible notes, and options – e.g., whether such instruments will be treated as covered transactions upon execution or at the time they are converted to equity.

2. **Revise definition of "covered foreign person" to create a standard that can be readily ascertained and applied and that does not sweep in entities engaged in *de minimis* levels of covered activities**

Treasury proposes in the ANPRM to define a "covered foreign person" as:

(1) a person of a country of concern that is engaged in, or a person of a country of concern that a U.S. person knows or should know will be engaged in, an identified activity with respect to a covered national security technology or product; or

(2) a person whose direct or indirect subsidiaries or branches are referenced in item (1) and which, individually or in aggregate, comprise more than 50 percent of that person's consolidated revenue, net income, capital expenditure, or operating expenses.

This definition is problematic for a number of reasons. As an initial matter, it is not clear under this definition what it would mean for an entity to be "engaged in" an identified activity with respect to a covered national security technology or product (what we refer to as a "covered activity"), especially in the context of a typical corporate structure that has a combination of operating and holding companies. In particular, it is not clear whether "engaged in" refers only to the operating company that employs the personnel who are directly involved in the covered activity, or whether a holding company may be considered to be "engaged in" a covered activity simply because it owns or controls, or is a material investor in, the operating company, or because its board of directors is responsible for directing the activities of an operating company engaged in a covered activity. These distinctions are relevant because most investments are made through holding companies, and not directly in operating companies. Unless Treasury clarifies this issue in the final rule, transaction parties will be unable to determine with confidence whether a potential counterparty is a covered foreign person, and whether a transaction therefore is a covered transaction. This may lead parties to treat certain transactions as presumptively prohibited – chilling beneficial business activity contrary to Treasury's intent – or to miss notification requirements or undertake prohibited transactions unintentionally despite their good faith efforts to comply with the EO.

Second, the ANPRM does not provide a threshold of covered activity that an entity would be required to meet before it is considered a covered foreign person. This could lead to unintended consequences where a transaction that has no nexus to covered national security technologies or products is prohibited because the counterparty undertakes *de minimis* covered activities that are completely unrelated to the transaction at issue. For example, under the definition proposed in the ANPRM, if 99 percent of a Chinese bank's operating expenses are attributable to banking activities unrelated to covered national security technologies or products, but one percent of its operating expenses are attributable to development of a quantum network or quantum communication system designed to be used exclusively for secure communications, such as quantum key distribution, that bank would be considered a covered foreign person, and any covered transaction involving the bank would be prohibited, even if the transaction in question had nothing to do with quantum technology.

In addition to such unintended consequences, it may be very difficult, if not impossible, for transaction parties in all circumstances to conduct the level of due diligence required to determine whether a counterparty is engaged in <u>any</u> covered activities at all. Levels of consolidated revenue, net income, capital expenditure, and operating expenses also fluctuate over time, meaning that an entity may or may not be a covered foreign person based on the time period in question. Treasury therefore should provide a clear and readily quantifiable threshold for a *de*

minimis level of covered activity in the final rule, in addition to a specific timeframe in which the relevant level of activity should be measured, to avoid the types of unintended consequences described above and to reduce to a certain extent the practical challenges of determining whether an entity is "engaged in" a covered activity.

Third, the proposed definition of covered foreign person includes "a person of a country of concern that a U.S. person knows or should know will be engaged in [a covered activity]." It is not clear from the ANPRM how a U.S. person should determine whether an entity "will be engaged in" a covered activity, or what it would mean that a U.S. person knows, or should know, that an entity will be engaged in a covered activity. In particular, it is not clear what actions an entity must take to meet the standard of "will be engaged in," or what level of due diligence a U.S. person will be obligated to undertake to satisfy the knowledge standard under this aspect of the covered foreign person definition. Rather than using a subjective standard focused on the U.S. person's ability to discern a counterparty's future intent, we recommend that the definition be revised to "or a person of a country of concern that has a demonstrated business objective to engage in [a covered activity]," drawing on a term from the CFIUS regulations. *See* 31 C.F.R. § 800.241(c)(5). This more objective standard will reduce ambiguity in the application of the EO and facilitate compliance therewith. It also would be helpful for Treasury to provide examples and other guidance to elaborate on the meaning of a "demonstrated business objective," as under the CFIUS regulations. *See id.*

Fourth, the definition of covered foreign person suggests that the EO would apply to a covered transaction involving an entity that is not itself engaged in a covered activity only if it has subsidiaries or branches that are covered foreign persons that comprise more than 50 percent of the parent company's consolidated revenue, net income, capital expenditure, or operating expenses. However, the inclusion of "indirect" in the definition of a covered transaction suggests that the EO also could apply to an investment in a company that does not meet either prong of the covered foreign person definition, but that has a minority investment in a third company that is a covered foreign person, under the logic that the U.S. person would be making an "indirect" investment in the covered foreign person through the non-covered foreign person. We do not read this to be Treasury's intent in including "indirect" in the definition of covered transactions, but Treasury should clarify this point in the final rule. Otherwise, the second prong of the covered foreign person definition would seem to be irrelevant, and transaction parties would be required to determine whether any subsidiary of an investee company – of which there could be hundreds – is a covered foreign person, regardless of the level of consolidated revenue, net income, capital expenditure, or operating expenses attributable to each subsidiary.

Lastly, to help facilitate compliance with the EO, Treasury should provide a public list of entities that are determined by the U.S. government clearly to be "covered foreign persons," and provide a mechanism of public and industry engagement to help Treasury update that list with relevant new market entrants, as appropriate.

3. Provide guidance regarding the "knowledge" standard and the level of due diligence parties are expected to undertake

Treasury proposes in the ANPRM to use a knowledge standard in its application of the EO, adopting the definition of "knowledge" from the Export Administration Regulations ("EAR"):

> "knowledge of a circumstance (including variations such as "know," "reason to know," or "reason to believe") 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 is inferred from evidence of a person's conscious

disregard of facts known to that person and is also inferred from a person's willful avoidance of facts."

Treasury indicates in the ANPRM that "to be covered by the regulations, a U.S. person would need to know, or reasonably should know 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."

Treasury should provide guidance in the final rule regarding what information transaction parties "reasonably should know" and what amount of due diligence Treasury would consider "reasonable and appropriate" in assessing a party's compliance with the EO. In providing this guidance, Treasury should account for the fact that the information available to transaction parties and the ability to conduct due diligence will vary significantly from transaction to transaction. Further, as indicated previously, Treasury should consider the possibility of potential conflicts of law from other jurisdictions that may place restrictions on the export of data from China and create other challenges in obtaining research on investment targets in China, including with respect to the makeup of a Chinese company's revenue, income, capital expenditure, and operating expenses, including how much is contributed by each subsidiary and branch, and whether any subsidiary or branch is engaged in any covered activities.

If Treasury determines that the final rule will impose compliance obligations on financial institutions engaged in secondary transactions or the provision of financial products or services, contrary to our recommendations in Section 1 of this letter, Treasury should make clear that such institutions will not be in violation of the EO if they rely upon the information available to them in the ordinary course of business in determining whether a transaction is a "covered transaction." This standard would be consistent with guidance issued by OFAC to comply with economic sanctions. See, for example, FAQ 901:

> "For purposes of assessing whether certain purchases or sales are permissible under E.O. 13959, as amended, U.S. persons — including financial institutions, registered broker-dealers in securities, securities exchanges, and other market intermediaries and participants — may rely upon the information available to them in the ordinary course of business."

See also FAQ 976:

> "For purposes of assessing whether certain transactions are authorized under [General License] 8C, U.S. persons may rely upon the information available to them in the ordinary course of business, including reasonable reliance on information about the underlying transaction provided by the parties thereto."

See also FAQ 1055:

> "For purposes of assessing [whether lending funds to, or purchasing a debt or equity interest in, entities located outside of the Russian Federation are specifically intended for new projects or operations in the Russian Federation or the entity located outside the Russian Federation derives 50 percent or more of its revenues from its investments in the Russian Federation], U.S. persons, including U.S. financial institutions, may reasonably rely upon the information available to them in the ordinary course of business, including publicly available information such as an entity's most recent quarterly or annual report."

Given that Treasury has taken the position that reliance upon information available to financial institutions in the ordinary course of business, such as in quarterly or annual reports, and reliance upon information about the transaction provided by the parties thereto (including through representations and warranties), is sufficient for compliance with U.S. economic sanctions issued under the authority of the International Emergency Economic Powers Act ("IEEPA"), it seems appropriate and consistent to apply this standard to the EO as well. Treasury should make this clear in the final rule.

Treasury also should clarify in the final rule that the prohibition and notification requirements under the EO apply only on the basis of information available to the U.S. person at the time of the transaction, meaning that a U.S. person would not be required to divest or unwind a transaction if, following consummation of the transaction, either (a) the U.S. person learned that a counterparty is a covered foreign person based on information that would not have been available to the U.S. person in the ordinary course of business at the time of the transaction, or (b) the counterparty later became a covered foreign person, after the U.S. person made their investment.

4. Clarify the meaning of "ownership interest"

Treasury proposes in the ANPRM to define "person of a country of concern" as:

(1) Any individual that is not a U.S. citizen or lawful permanent resident of the United States 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, including any political subdivision, political party, agency, or instrumentality thereof, or any person owned, controlled, or directed by, or acting for or on behalf of the government of such country of concern; or

(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.

Likewise, Treasury indicates in the ANPRM that it is considering defining a "controlled foreign entity" – for which a U.S. person would be responsible for ensuring compliance with the EO – as a foreign entity in which a U.S. person owns, directly or indirectly, a 50 percent or greater interest.

Treasury should clarify that "ownership interest" in this context refers to an equity interest with a commensurate voting interest (i.e., an equity interest of 50 percent or greater along with a 50 percent or greater voting interest). Including voting interest in the definition will ensure that non-Chinese entities are not treated as persons of a country of concern when they may be owned but not controlled by Chinese parties, and, likewise, that U.S. persons will not be required to ensure compliance by non-U.S. entities that they may own but not control. Similarly, a non-U.S. trust should not be considered to be "owned" by a U.S. person for purposes of the prohibition and reporting requirements under the EO unless both the beneficiary and the trustee are U.S. persons.

In addition, or in the alternative, Treasury should clarify the meaning of "ownership interest," including whether it should be calculated on a fully-diluted or outstanding basis,

whether preferred equity (including non-convertible preferred equity) constitutes an "ownership interest," and how "ownership interest" would apply in the context of limited partnerships, limited liability companies, trusts, and other scenarios where legal ownership and control may be divided between multiple persons.

5. **Clarify the scope of greenfield investments and joint ventures subject to the EO**

Treasury proposes to define "covered transactions" to include "greenfield investments that *could* result in the establishment of a covered foreign person" and the "establishment of a joint venture, wherever located, that is formed with a covered foreign person or *could* result in the establishment of a covered foreign person." "Could" is vague and overbroad. Treasury should replace "could result in the establishment of" with "has a demonstrated business objective to establish," borrowing a term from the CFIUS regulations. *See* 31 C.F.R. § 800.241(c)(5). In assessing whether such a demonstrated business objective exists, financial institutions engaged in secondary transactions or providing financial products or services, if covered by the final rule, should be permitted to rely on information available to them in the ordinary course of business.

Treasury also should clarify that a "greenfield investment" refers only to the establishment of a new legal entity, and not to the provision of capital or resources to, or expenditure of capital or utilization of resources by, a preexisting legal entity.

6. **Exception for intracompany transfers should apply to all companies regardless of domicile**

The ANPRM proposes to exempt from the scope of covered transactions an "intracompany transfer of funds from a U.S. parent company to a subsidiary located in a country of concern." To provide consistency within the regulations, this exception should be expanded to include intracompany transfers of funds from non-U.S. companies to subsidiaries located in countries of concern where a U.S. person "directs" the transaction. This revision will help avoid the unintentional unequal treatment of non-U.S. entities that may employ U.S. persons, including those that may be based in countries that are U.S. allies.

7. **Define "publicly traded securities" in line with Executive Order 14032**

SIFMA supports Treasury's proposal in the ANPRM to exempt investments in publicly traded securities, index funds, mutual funds, exchange-traded funds, and similar instruments (including associated derivatives). The ANPRM defines an "excepted transaction" in part as "an investment into a publicly traded security, with 'security' defined as set forth in section 3(a)(10) of the Securities and Exchange Act of 1934." Treasury also should include a definition of "publicly traded securities" in line with the definition included in Executive Order 14032: "any 'security,' as defined in section 3(a)(10) of the Securities Exchange Act of 1934, Public Law 73-291 (as codified as amended at 15 U.S.C. 78c(a)(10)), denominated in any currency that trades on a securities exchange or through the method of trading that is commonly referred to as 'over-the-counter,' in any jurisdiction." In adding this definition, Treasury may wish to define "over-the-counter," which is not defined in the context of Executive Order 14032, to reduce ambiguity in the application of the EO.

Treasury also should clarify that the definition of "publicly traded securities" for purposes of "excepted transactions" includes subscriptions to initial public offerings ("IPOs"). IPOs refer to the process of offering shares of a private corporation to the public in a new stock issuance for the first time. After an IPO is completed, the new stock is a publicly traded security. By clarifying

that the definition of "excepted transaction" includes subscriptions to IPOs, Treasury would avoid potentially arbitrarily excluding U.S. investors from subscribing to an IPO while allowing them to purchase the same stock a short time later once it is considered a publicly traded security.

Further, insofar as the ANPRM exempts from the EO investments in publicly traded securities and investments in index funds, mutual funds, exchange-traded funds, or similar instruments (including associated derivatives), Treasury also should include an exemption for swaps, futures, and any other instruments that reference publicly traded securities, as well as convertible bonds, warrants, and other instruments that are convertible into or exchangeable for publicly traded securities.

8. Clarify the exception for passive investments

Treasury proposes in the ANPRM to create an exception for certain investments "made as a limited partner into a venture capital fund, private equity fund, fund of funds, or other pooled investment funds," subject to certain conditions relating to the passivity of the investment. Treasury explains that the rationale for this exception is that these types of transactions are less likely to provide to a covered foreign person the intangible benefits that the EO seeks to restrict, such as standing and prominence, managerial assistance, and enhanced access to capital. Treasury does not propose, however, to include an exception for any other types of passive transactions that do not convey the types of intangible benefits about which Treasury is concerned. We therefore recommend that Treasury adopt in the final rule an exception to include transactions that result in the U.S. person holding 10 percent or less of the equity interest and voting interest in a covered foreign person (regardless of the dollar value of the interest so acquired), and that are solely for the purpose of passive investment – i.e., the investment does not afford the U.S. person (i) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors or an equivalent governing body of the covered foreign person, (ii) any other involvement, beyond the voting of shares, in substantive business decisions, management, or strategy of the covered foreign person, or (iii) any other involvement that would afford the covered foreign person the types of intangible benefits targeted by the EO. *C.f.* 31 C.F.R. § 800.302(b).

9. Clarify the exception for investments made as a limited partner in a fund

An investment as a limited partner into a venture capital fund, private equity fund, fund of funds, or other pooled investment funds should not constitute a "covered transaction" simply because the limited partner is a member of a limited partner advisory committee ("LPAC") or substantially similar body of the investment fund, so long as the LPAC does not control investment decisions of the fund or decisions made by the general partner, managing member, or equivalent, related to entities in which the fund is invested. Treasury could look to the Specific Clarification for Investment Funds in the CFIUS regulations as a model. *See* 31 C.F.R. § 800.307(a)(3).

10. Further refine categories of national security products and technologies

AI systems and quantum information technology are broad categories that can include beneficial applications in which the United States may not want to discourage investment, even in countries of concern. The final rule therefore should include carve-outs for AI systems and quantum information technologies where the end use supports the policy interests of the United States, such as in combatting fraud, compliance with anti-money laundering laws and regulations,

and compliance with export controls and economic sanctions. In this regard, it would be helpful for Treasury to use "exclusively" with respect to covered end uses, rather than "primarily," and, as a general matter, it will be critical to have a clear, well-defined scope of "covered national security technologies or products" to facilitate compliance by U.S. persons with the final rule.

11. Treasury should issue FAQs with guidance for parties to comply with the EO

As in the context of OFAC's administration of U.S. economic sanctions programs, and the Office of Investment Security's administration of the CFIUS regulations, Treasury should issue "FAQs" containing guidance and examples for parties seeking to comply with the EO, particularly if Treasury does not plan to create a formal authorization or other process to provide parties with certainty regarding whether a transaction is prohibited, notifiable, or neither. Treasury also may consider adopting an advisory opinion process to allow parties to submit requests to Treasury for interpretive guidance.

In addition to FAQ guidance and an advisory opinion process, Treasury should provide a hotline or other means by which industry can (a) ask clarifying questions about the application of the EO in real time as they are considering investments, and (b) obtain information about companies that Treasury may know are covered foreign persons. These tools all have proven extremely useful to transaction parties – and, we believe, Treasury – in navigating compliance with U.S. economic sanctions.

12. Treasury should create a formal authorization process

Beyond granting "national interest exemptions" in extraordinary circumstances, Treasury does not propose in the ANPRM to create a formal authorization or waiver process for transactions that otherwise would be prohibited. Given the potentially broad application of the EO, there should be a formal process to allow transaction parties to apply for authorization to enter into transactions that otherwise would be prohibited, rather than relying on ad hoc "national interest exemptions" issued by Treasury.

An authorization or waiver process would provide an important safety valve to allow parties the opportunity to bring to Treasury's attention transactions that may not have been intended to be prohibited by the EO, but that may be inadvertently prohibited as a legal matter based on the wording of the final rule. Creating such a process would be especially important for the implementation of the EO because it is the first time that the United States, or any of its peer countries, has implemented outbound investment controls. For that reason, even with the most careful drafting, there inevitably will be unintended consequences and gray areas that can be resolved only by Treasury.

If the final rule does not provide an off-ramp for Treasury to authorize transactions that are prohibited unintentionally (but which are consistent with U.S. policy interests), or that are subject to ambiguity, parties will be required to treat such transactions as *de facto* prohibited. The regulatory regimes on which the ANPRM draws – U.S. sanctions, export controls, and CFIUS – all provide the regulating agency with the ability to approve transactions that otherwise would be prohibited (or, in the CFIUS context, transactions that could be prohibited). Providing for an authorization or waiver process in the final rule would benefit not only potential transaction parties, but also Treasury itself, such that Treasury would not feel its hands are tied in the event it encounters a transaction that is prohibited inadvertently by the final rule, or where Treasury wishes to provide transaction parties with certainty regarding a transaction to which the application of the final rule is ambiguous.

13. **Treasury should provide clear guidance on how it will implement penalty authorities, and apply those authorities in a manner that takes into account business realities**

Treasury indicates in the ANPRM that it is considering penalizing the following with a "civil penalty up to the maximum allowed under IEEPA": "(i) material misstatements made in or material omissions from information or documentary material submitted or filed with Treasury; (ii) the undertaking of a prohibited transaction; or (iii) the failure to timely notify a transaction for which notification is required."

In the event that the final rule will impose any compliance obligations on financial institutions engaged in secondary transactions or the provision of financial products or services, contrary to what we understand to be Treasury's intent, any such financial institution should not be subject to penalties – and should receive safe harbor therefrom – if the financial institution made a good faith effort to determine whether a transaction was a "covered transaction," including in reliance upon representations made by the parties to the transaction, but ultimately was unable to make an accurate determination based on the information available to it in the ordinary course of business. In this regard, financial institutions should not be held to the same standard as Covered Investors because, in many cases, financial institutions will not have the ability as a practical matter to conduct the level of diligence required to determine whether a transaction is a covered transaction. Financial institutions instead should be held to a recklessness or willfulness standard if they are not acting as Covered Investors.

Moreover, as OFAC has done with respect to economic sanctions programs, and the Office of Investment Security has done for CFIUS, Treasury should provide detailed enforcement guidelines specific to this program at the time the regulations are finalized, which would provide transparency and notice to the regulated public on how Treasury will approach enforcement cases. Such guidelines should include, among other things, an explanation of under what circumstances Treasury would refer matters to the Department of Justice for criminal investigation.

Treasury also should include in the final rule a list of factors that will be taken into consideration when assessing penalties, as in the guidelines issued by OFAC (Appendix A to 31 C.F.R. part 501) and CFIUS (*available at* https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-enforcement-and-penalty-guidelines), including:

- Whether the conduct was willful or reckless (or neither);
- Whether the U.S. person had actual knowledge of a violation or the facts constituting a violation;
- Whether the U.S. person reasonably relied on information provided by its counterparty, including through contractual representations and warranties;
- Whether the U.S. person made a good faith attempt to comply with the EO, e.g., based on a reasonable interpretation of the implementing regulations;
- Whether the conduct harmed U.S. policy interests;
- Whether the U.S. person had an adequate compliance program in place;

- Whether the U.S. person voluntarily undertook corrective actions to remediate any issues that led to the violation and to prevent future violations;

- Whether the U.S. person voluntarily disclosed the violation and cooperated with Treasury in connection with the disclosure; and

- Other individual factors regarding the U.S. person and the conduct at issue that might weigh in favor of a reduction or elimination of penalties.

Finally, failure to timely notify a covered transaction should be penalized less heavily than undertaking a prohibited transaction.

14. The notification process should be appropriately tailored and manageable

Treasury indicates in the ANPRM that it is considering requiring U.S. persons to furnish a significant amount of information as part of a required notification. It may not be possible in every case to obtain certain of this information, especially with respect to covered transactions that take place in China – in particular, "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." The requirement to provide this information should be subject to the U.S. person's practical ability to obtain it, and in any case subject to compliance with applicable laws and regulations.

Treasury also should clarify that it may be permitted to ask a U.S. person follow-up questions about its notification for purposes of completeness – e.g., if a required field is left blank or lacks certain required elements – but the notification process should not include Q&A outside the scope of the notification itself, such as in the CFIUS Q&A process.

Finally, as indicated previously, only the Covered Investor (i.e., the entity or individual undertaking the covered transaction), and not any other party to a transaction, such as the person selling an equity interest or a third party otherwise involved in the transaction, should be required to submit a notification with respect to a covered transaction.

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SIFMA appreciates the opportunity to provide these comments and looks forward to continued engagement with Treasury on these issues.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO