TheCityUK Comments on Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern

Introduction

1. TheCityUK is the industry-led body representing United Kingdom-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK, across Europe and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes over 12% of the UK's total economic output and employs nearly 2.5 million people, with two thirds of these jobs outside London, across the country's regions and nations. It is the UK's largest net exporting industry and generates a trade surplus exceeding that of all other net exporting industries combined. It is also the largest taxpayer and makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and protect and manage risk.

2. We welcome the opportunity to comment on the advance notice of proposed rulemaking (ANPRM) on various topics related to the implementation of the Executive Order (EO) "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern".

3. The ANPRM notes that the program is confined to the three high-level categories of the technologies and products identified and is "not intended to impede all U.S. investments into a country of concern or impose sector-wide restrictions on United States person activity". We note that the various definitions of key terms will be developed throughout the rulemaking process. Therefore, **the impact of the proposed measures – in terms of achieving their policy objective and the potential to create unintended consequences – will depend on the clarity of the definitions provided in the final regulations, and how they are interpreted by government and firms.**

4. We also note that the ANPRM states that the Treasury Department expects the implementing regulations to apply to U.S. persons "wherever they are located". The proposed regime is, therefore, of significant interest to our members, given the strong U.S.-UK investment relationship. The UK is home to many U.S. financial and related professional services firms, and there is a significant number of U.S. persons employed in senior roles in UK-based firms.

Scope and sector definitions

5. We note that the proposed measures will apply to the three high-level categories of technologies and products (1) semiconductors and microelectronics, for which Treasury is considering a prohibition on transactions related to certain advanced technologies and products, and considering a notification requirement related to other technologies and products; (2) quantum information technologies, for which Treasury is considering a prohibition on transactions related to certain technologies and products; and (3) AI systems, for which Treasury is considering a notification requirement for transactions related to certain technologies and products with specific end uses and is considering a prohibition in certain other cases.

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6. Within these high-level technology and product categories, **it will be important that the definitions give clarity to investors about the due diligence they will need to carry out on individual transactions and throughout their investment supply chains**.

7. For example, the suggested definition of "AI system" is a broad one, incorporating any "engineered or machine-based system that can, for a given set of objectives, generate outputs such as predictions, recommendations, or decisions influencing real or virtual environments." This definition could encompass many varieties of software.

8. The ANPRM notes that the policy objective is to cover U.S. investment into entities that develop AI systems that have applications that pose significant national security risks "without broadly capturing entities that develop AI systems intended only for consumer applications or other civilian end uses that do not have national security consequences." Treasury also notes that a potential approach to the requirement threshold for prohibition in this category would be to substitute "primarily used", in place of "exclusively used", for "military, government intelligence, or mass-surveillance end uses". **Given that AI is a fast-moving technology area with an ever-growing range of applications, this broader definition could introduce significant ambiguity. Investors would benefit from greater clarity about the apparent intent to capture dual-use AI systems.**

9. In all three high-level categories it would benefit investors to give clarity on how many "degrees of separation" along the investment chain they will be considered liable for the potential involvement of a "covered foreign person". For example, an asset manager may have an investment in a private entity via an SPV structure which is domiciled in one country, held via a fund domiciled in another country. The fund is then managed by an individual in a separate country and could have investors from a number of jurisdictions globally, including the U.S.

10. Equally, we note that Treasury is considering including "indirect" transactions as "covered transactions" in order to close loopholes that would otherwise result. The given example of such conduct includes "a U.S. person knowingly investing in a third-country entity that will use the investment to undertake a transaction with a covered foreign person that would be subject to the program if engaged in by a U.S. person directly". This could give rise to a scenario where an investor is comfortable that the investee they are dealing with directly is not a "covered foreign person" but remains uncertain about what level of due diligence will be required on their counterparty's supply chain to meet the knowledge threshold established by the regulations. **The regulations should provide clarity on the boundaries of where the regime applies down the investment chain and guidance on the appropriate levels of due diligence expected to comply with the knowledge requirements.**

11. The ANPRM notes that the programme is not intended to capture a range of activities unless undertaken as part of an effort to evade the rules. These activities include bank lending, payment services, underwriting services, prime brokerage, global custody, and equity research or analysis. **The final regulations should clarify that the scope of "covered transactions" does not include secondary or intermediary services provided by financial institutions. Without clarity and guidance on these points, the risk is that individual firms will need to make overly cautious assessments of their individual liabilities, which could lead to an unintended "chilling effect" on investment opportunities.**

12. The EO states that it is aimed at outbound U.S. investments and the "intangible benefits that accompany such investments". The ANPRM notes that Treasury is considering introducing a defined threshold, such as the size of a limited partner's investment or the size of the limited partner itself, to capture those transactions which are more likely to involve the conveyance of intangible benefits, such as "standing and prominence, managerial assistance, and enhanced access to additional funding." Therefore, **investors would benefit from greater clarity about the definition of "investment", including the intended meaning of "intangible benefits", which might, for example, include the training of cross-border talent, and whether the material threshold for prohibition or notification is solely the level of capital investment or whether intangible benefits will be taken into account.**

Reach: entities and transactions covered

13. The ANPRM states that Treasury expects the implementing regulations to apply to U.S. persons "wherever they are located". We also note that the EO states that the Secretary [of the Treasury] may prohibit U.S. persons from "knowingly directing" transactions if such transactions would be prohibited transactions pursuant to the order if engaged in by a U.S. person. Therefore, the proposals would include transactions by non-U.S. persons or entities when there is U.S. person involvement, in certain circumstances.

14. Treasury is considering defining "knowingly" for purposes of this provision in the EO to mean that the U.S. person had "actual knowledge, or should have known, about the conduct, the circumstance, or the result". And the Treasury Department is considering defining "directing" to mean that a U.S. person "orders, decides, approves, or otherwise causes to be performed a transaction that would be prohibited under these regulations if engaged in by a U.S. person".

15. For example, Treasury describes a scenario, which would be captured, where "A U.S. person is an officer, senior manager, or equivalent senior-level employee at a foreign fund that undertakes a transaction at that U.S. person's direction when the transaction would be prohibited if performed by a U.S. person." In contrast, Treasury currently *does not* intend "knowingly directing" transactions to cover a scenario in which "A U.S. person serves on the management committee at a foreign fund, which makes an investment into a person of a country of concern that would be a prohibited transaction if performed by a U.S. person. While the management committee reviews and approves all investments made by the fund, the U.S. person has recused themself from the particular investment."

16. **It will be important for the final regulations to provide clarity and precision on this distinction, such as by clarifying that "directing" a transaction means that the U.S. person has the power, either individually or as part of a group, to make decisions on behalf of the entity making the transaction, and exercises that power with respect to the transaction in question.**

17. **The final rule should make clear that the obligation to comply with any prohibition or notification requirement under the EO – and liability for non-compliance – resides solely with the U.S. person undertaking a covered transaction, or knowingly directing a prohibited 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, issuer, or in any other capacity as a financial institution acting in an intermediary or other capacity.** If the final rule instead

requires U.S. person employees of foreign financial institutions, to identify, prevent, or notify the U.S. Government of potentially covered transactions in which they may be involved as issuers of equity, or debt, or as providers of other financial services, it could discourage financial institutions from employing U.S. persons. **It would also be useful for Treasury to provide guidance on how third-country firms with US personnel can assess their internal procedures for ensuring compliance.**

18. **Treasury should also publish a list of entities that it has determined are "covered foreign persons", or that have been identified as "covered foreign persons" in notifications submitted to Treasury by U.S. persons. While such a list would not be the exhaustive list of covered foreign persons, it would provide greater certainty on dealings with the entities included on the list.**

19. In addition, Treasury states that it is considering how to apply the proposals to "controlled foreign entities". Currently, Treasury is considering defining a ''controlled foreign entity'' as "a foreign entity in which a US person owns, directly or indirectly, a 50 percent or greater interest". Under that definition, a third-country general partnership fund 50 percent or more owned, directly or indirectly, by US persons would be a "controlled foreign entity" and would be subject to the notification/prohibition restrictions.

20. However, the ANPRM proposes a category of "excepted transactions" that "due to the nature of the transaction, present a lower likelihood of concern." Currently, Treasury is considering including certain limited partnership investments in the definition of "excepted transaction". The exception criteria being considered includes a limited partner investment "into a venture capital fund, private equity fund, fund of funds, or other pooled investment funds, in each case where A. the limited partner's contribution is solely capital into a limited partnership structure and the limited partner cannot make managerial decisions, is not responsible for any debts beyond its investment, and does not have the ability (formally or informally) to influence or participate in the fund's or a covered foreign person's decision making or operations and B. the investment is below a de minimis threshold to be determined by the Secretary".

21. Against this, the ANPRM suggests that any investment that confers certain rights to U.S. persons *would not* be eligible for the exception. These rights would include, but would not be limited to, board member or observer rights including nomination rights, or any involvement other than voting of shares in substantive decision making, including management or strategy decisions of the target entity. **The final regulations should clarify that an otherwise excepted transaction by a limited partner investor in an investment fund does not become a covered transaction by virtue of a limited partner's participation on an industry-standard limited partner advisory committee.**

TheCityUK
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