The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

August 2, 2024

U.S. Department of the Treasury
Attention: Meena Sharma
Acting Director, Office of Investment Security
1500 Pennsylvania Avenue, NW
Washington, DC 20220

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

Dear Ms. Sharma:

The Investment Company Institute (ICI)[1] appreciates the opportunity to provide comments on the U.S. Department of the Treasury's (Treasury) Notice of Proposed Rulemaking regarding Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern (NPRM),[2] which has been issued as the second step in implementing regulations to effectuate the August 9, 2023, Executive Order "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (Executive Order). The NPRM follows Treasury's Advance Notice of Proposed Rulemaking (ANPRM) issued August 9, 2023, to which ICI provided feedback on September 28, 2023.[3]

ICI continues to believe that careful calibration is essential for the adoption of a program that prescribes actionable requirements for U.S. investors to achieve Treasury's goals, while also seeking to maintain the United States' longstanding commitment to open investment that has

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[1] The Investment Company Institute (ICI) is the leading association representing the asset management industry in service of individual investors. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage $35.7 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional $9.3 trillion in regulated fund assets managed outside the United States. ICI also represents its members in their capacity as investment advisers to certain collective investment trusts (CITs) and retail separately managed accounts (SMAs). ICI has offices in Washington DC, Brussels, and London and carries out its international work through ICI Global.

[2] The NPRM is available at https://www.govinfo.gov/content/pkg/FR-2024-07-05/pdf/2024-13923.pdf.

[3] ICI's feedback to the ANPRM is available at https://www.ici.org/system/files/2023-09/23-cl-treasury-anprm.pdf.

served the U.S. capital markets well for decades. We greatly appreciate Treasury's efforts, reflected in both the ANPRM and the NPRM, to tailor the implementing regulations appropriately to address the stated national security concerns while mitigating unintended consequences and without unnecessarily burdening U.S. persons. We also appreciate Treasury's responsiveness to the feedback provided by ICI to the ANPRM.

Similar to our feedback on the ANPRM, our feedback to the NPRM primarily focuses on the rulemaking's application to U.S. asset managers and the funds and other products that they manage. We address areas that would benefit from further clarity and precision to enable U.S. persons, including our members, to implement a workable and effective compliance program that is consistent with the goals of the U.S. government regarding the U.S. outbound investment program. Below, we provide an executive summary followed by comments on select provisions of the NPRM, beginning with those that are most relevant to our members.

I. Executive Summary

ICI supports efforts to maintain U.S. national security. A thoughtful and carefully calibrated U.S. outbound investment program will prescribe actionable requirements for U.S. persons that achieve Treasury's goals while mitigating unintended consequences.

We strongly support the proposed exception for investments in publicly traded securities. When finalizing the rule, we recommend that Treasury clarify that the exception also includes rights, warrants, and derivative contracts with publicly traded security reference assets, as well as futures on broad-based indexes.

We strongly support the proposed exception for registered investment companies and business development companies. We recommend that that the language for this exception be amended to also clearly include common and collective investment funds that are exempt from registration under the Investment Company Act of 1940 (1940 Act) pursuant to Section 3(c)(3) or Section 3(c)(11) thereof (CITs).[4] Treasury has appropriately recognized that certain types of collective investment vehicles are highly unlikely to present the risks that the Executive Order aims to address, and this revision would help ensure that this important exception achieves its intended purpose without creating unintended ambiguity.

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[4] CITs are tax-exempt, pooled investment vehicles maintained by a bank or trust company (the "trustee") exclusively for qualified retirement plans that are exempt from federal income tax, including 401(k) plans, defined benefit plans, Taft-Hartley plans, and certain government plans. Like mutual funds, they are comprised of an investment portfolio managed by a professional with a defined investment objective.

We further recommend that the proposed rule be clarified in certain areas, as specified below, to improve the effectiveness of the program and assist U.S. persons in its operationalization.

Finally, while we understand that Treasury is not inclined to adopt a government-issued, list-based approach for identifying covered foreign persons under this program, we continue to urge consideration of such an approach in order to achieve the U.S. government's intended goals in a manner that is better suited for broad implementation.

II. Definition of Excepted Transaction

Question 21: Are there categories of transactions that should be added to, or removed from, the definition of *excepted transaction* in light of the national security concerns identified in the Outbound Order? If so, what are they and why? What potential consequences should the Department of the Treasury consider in limiting the applicability of the definition of *excepted transaction* to a transaction made pursuant to a binding, uncalled capital commitment entered into before August 9, 2023?

We support Treasury's proposal to except certain types of transactions from the notification requirement and prohibition restriction on the basis that these types of transaction have a lower likelihood of resulting in the transfer of the intangible benefits about which Treasury is concerned. We broadly support the types of excepted transactions included in §850.501(a)-(f) and recommend that Treasury preserve the types of transactions that have been enumerated, with the clarifications we note below. We further recommend that Treasury revise this Section to include a de minimis exception for an investment of less than five percent of an entity's equity interest, as discussed below.

Investments in common and collective investment funds

We support the proposed exception for an investment into a registered investment company or business development company as specified in §850.501(a)(1), and appreciate Treasury having clarified some of the definitions included under this exception relative to the original language in the ANPRM. To further eliminate ambiguity and clarify what we believe is the intended scope of this exception, we urge Treasury to also include in the regulatory text in 501(a)(1) "common and collective investment funds that are exempt from registration under the Investment Company Act pursuant to Section 3(c)(3) or Section 3(c)(11) thereof but are subject to federal or state banking authority." As Treasury has appropriately recognized with respect to investments in registered investment companies or business development companies, investments by U.S. persons into common and collective investment funds present a similar low likelihood of concern.

Clarifying the scope of publicly traded securities

Rights, warrants, and derivative contracts with publicly traded security reference assets

We support the proposed exception for publicly traded securities and the changes made to align the definition of "publicly traded security" with that under the Chinese Military Companies Sanctions program. We further request that Treasury clarify that rights, warrants, and derivative contracts that are issued in respect of, or that use as their reference asset, publicly traded securities will be treated as excepted. Such clarification would align the U.S. outbound investment program with Treasury's other regulatory regimes and would reduce the potential for confusion and unnecessary burdens for U.S. persons that must operationalize a compliance program across multiple sets of regulations and requirements.

Futures contracts on broad-based indexes

We also recommend that Treasury except investments in futures contracts on broad-based indexes, and options and swaps involving such futures. The proposed rule excepts investment into a publicly traded security, with "security" defined as set forth in section 3(a)(10) of the Securities Exchange Act of 1934, and that trades on a securities exchange or through the method of trading that is commonly referred to as "over-the-counter," in any jurisdiction. However, under the definition of security under the Securities Exchange Act, futures on broad-based indexes (such as foreign futures contracts that have been approved by the Commodities Futures Trading Commission), as well as options and swaps on such contracts, are not considered to be securities and therefore would not be within the scope of excepted transactions as currently drafted. Given the rationale for the publicly traded securities exception, we believe investments in futures contracts should also be excepted as they present a similar low likelihood of concern. Specifically, they do not involve the acquisition of an equity interest in the underlying constituents of an index, are settled in cash and do not involve delivery of equity securities of constituents, and also would not involve transfers of intangible benefits.

Lending transactions and other similar financial arrangements

We support the proposed exception for the acquisition of a voting interest upon default or other condition involving a loan or other financial arrangement as specified in §850.501(a)(1). We recommend that Treasury clarify that the exception covers loans made by non-bank syndicates as well as bank syndicates. This will provide clarity to market participants that engage in non-bank syndicated lending activities, which we believe the U.S. outbound investment program does not intend to implicate.

Inclusion of a de minimis threshold

We recommend that Treasury include as an excepted transaction an investment in a covered foreign person that does not exceed a de minimis threshold. For example, we recommend that an investment representing less than five percent of the equity interest of a covered foreign person be excepted. The rationale for an exception for a de minimis investment of the equity of an entity is similar to the rationale put forward by Treasury with respect to a de minimis exception for certain limited partner investments. These investments present a lower likelihood of risk because they are less likely to convey the intangible benefits about which the U.S. government is concerned. The due diligence that will be required to be performed on non-excepted transactions will be complex and time-consuming. Requiring "U.S. persons" to undertake such extensive due diligence for an investment of less than five percent of an entity's equity interest would impose upon U.S. persons a burden that is not commensurate with the risks that are presented.

Binding, uncalled capital commitment application date

We do not agree with the timing of Treasury's proposal to limit the applicability of the definition of excepted transaction to a transaction made pursuant to a binding, uncalled capital commitment entered into before August 9, 2023. Rather, the relevant lookback period should begin on the date on which the U.S. outbound investment program implementing regulations become effective. Our members are committed to developing the necessary compliance procedures and operational processes needed to comply with the U.S. outbound investment program; however, such efforts cannot be set in place until the implementing regulations have been finalized and published. Making the requested change would also be consistent with the U.S. government's stated intention that the U.S. outbound investment program's implementing regulations will not have retroactive application.

Standard minority shareholder right - putting forward directors

We recommend that Treasury include an additional note to §850.501 clarifying that an investment in a security that results in a U.S. person having the right to put forward a proposal to elect directors to a shareholder vote under the laws or rules to which an entity is subject would not, in and of its own, result in such U.S. person being afforded rights beyond standard minority shareholder protections. Alternatively, we recommend that Treasury clarify that such investments are excepted transactions unless and until such time as a U.S. person exercises the right to nominate a director.

The rules and regulations for listed companies in China and some other jurisdictions give shareholders that own a relatively low set percentage of voting shares (i.e., three percent) the right to put forward proposals, including proposals to nominate directors, at a shareholder

meeting. Including the clarifications we have recommended would avoid any ambiguity regarding this situation.

Question 22: Which of the two proposed alternatives for the exception for LP investments in the definition of excepted transaction best addresses national security concerns while minimizing disruptive effects? Should either approach and corresponding threshold for the exception be adjusted, and if so, why and how? What consequences could result from basing an exception on either of the proposed thresholds? What are the considerations related to compliance by *U.S. persons?* Where available, please support your answer with data about the type, aggregate number, or total dollar equivalent amount of investments that would be excepted under each of the two proposed alternatives.

ICI supports Alternative 1, which proposes, among other elements, that a limited partner's committed capital is "not more than 50 percent of the total assets under management of the fund." This approach gives investors the flexibility to participate in a limited partnership investment without a financial cap (as compared to Alternative 2 which sets a cap of $1,000,000), while including safeguards designed to limit the risk that the investment could lead to the transfer of intangible benefits about which the U.S. government is concerned.

III. Definition and Identification of a Covered Foreign Person; Person of a Country of Concern

Question 6: How do U.S. persons anticipate ascertaining the information necessary to comply with paragraph (a)(2) of the definition of covered foreign person at §850.209? How, if at all, should this definition be adjusted for a situation in which no financial statement (audited or otherwise) is available for a covered foreign person?

Definition of covered foreign person

Under the NPRM, a person would be a covered foreign person even if it is not itself a person of a country of concern or engaged in a covered activity if the person has a relationship with a person of a country of concern that is engaged in a covered activity that meets two specified conditions – there is a vested interest between the two parties, and the interest is above the 50 percent threshold. In paragraph (a)(2) of §850.209, Treasury specifies that the 50 percent threshold may be reached through one of four elements of the financial statements: consolidated revenue, net income, capital expenditures, and operating expenses. We recommend that Treasury modify this paragraph so that it includes only consideration of consolidated revenue and net income, and does not also include consideration of capital expenditures or operating expenses. Consolidated revenue and net income serve as a reasonable and familiar test for determining whether an entity should be considered a covered foreign person. This information also is easier to obtain in the ordinary course of business compared to information about capital expenditures or operating expenses.

Question 3: What considerations should the Department of the Treasury take into account with respect to the ease or difficulty with which a U.S. person will be able to comply with the proposed rule, particularly with respect to ascertaining whether an investment target or relevant counterparty is a person of a country of concern and engaged in a covered activity?

Identification of covered foreign persons

The NPRM's proposed approach of relying on U.S. persons to identify covered foreign persons will require U.S. persons to undertake heightened due diligence efforts that will impose a significant burden on U.S. persons, particularly those that engage in the types of transactions that are not excepted. As we stated in our feedback to the ANPRM, we believe that a list-based approach would serve the Administration's goals without unduly burdening U.S. persons. Please see our comments to the ANPRM[5] regarding the compliance and operational challenges posed by the proposed approach.

Publication of a non-exhaustive list

As Treasury has determined not to publish a list identifying all covered foreign persons, we request that Treasury at a minimum maintain and make public an updated, non-exhaustive list of those persons that it has determined are covered foreign persons under the program (specifying whether notifiable or prohibited). For example, as companies submit notifications to Treasury, Treasury could make public whether it agrees with such determination as of that date. While this alternative list would provide a reduced benefit to U.S. persons because they would still be required to perform extensive due diligence with respect to persons not identified on the list, it would reduce the risk of inconsistent application, complexity, and the overall operational burden by (1) providing certainty regarding those entities included in the list, and (2) serving as a useful guide regarding the types of entities that Treasury intends to be in scope.

Optional advisory opinion process

Because of the complexity in identifying covered foreign persons, as described above, we recommend that Treasury institute an optional advisory opinion process that would allow U.S. persons, at their discretion, to engage with Treasury officials to obtain guidance regarding whether a specified transaction is permitted, prohibited, or notifiable at the time of the inquiry.

[5] ICI's feedback to the ANPRM is available at https://www.ici.org/system/files/2023-09/23-cl-treasury-anprm.pdf.

Anonymized publication of notified transactions

We also recommend that Treasury consider publishing anonymized information regarding covered transactions in an annual report, similar to the annual reports issued by the Committee on Foreign Investment in the United States, in a manner that would provide useful guidance to the investing community.

Capital commitments and other contractual obligations

We recommend that Treasury clarify that in the case of binding, uncalled capital commitments and other contractual obligations subject to performance after the date of closing of a transaction, an analysis of whether the fulfillment of those obligations is either notifiable or prohibited should be based on the status of the entity at the time of the closing of the original transaction. Providing the clarification requested above would be consistent with the stated intention that U.S. outbound investment program's implementing regulations will not have retroactive application.

IV. Definition of Joint Venture

Question 23: What adjustments, if any, should be made to the proposed rule to clarify the coverage with respect to a greenfield investment, brownfield investment, or joint venture that is a *covered transaction* versus an intracompany transaction to support ongoing operations or other activities in a *country of concern* that is an *excepted transaction?*

Paragraph (5) of §850.210 covers "entrance into a joint venture, wherever located, that is formed with a person of a country of concern and that the subject U.S. person knows at the time of entrance into the joint venture will engage in or the U.S. person intends to engage in a covered activity." The term "joint venture" is undefined and, due to the wide range of possible business arrangements between U.S. persons and foreign persons, the lack of a definition could result in uncertainty regarding whether an arrangement is in scope. Treasury should further specify or define what arrangements are intended to be in scope. We recommend defining the term joint venture as "a contractual arrangement undertaken jointly by two or more parties for the development of a joint enterprise in which each party contributes both capital and management resources."

In addition, we recommend that Treasury make clear the application of requirements to joint ventures that have been entered into prior to the effective date of the U.S. outbound investment program. In particular, we request that Treasury:

- Affirmatively provide that the continued participation by a U.S. person in an existing joint venture is permissible;

- Specify whether the acquisition of an additional interest in an existing joint venture is permissible; and

- Confirm that if an existing joint venture engages in a covered activity the U.S. person is not required to exit the joint venture.

V. Debt Financing

Question 8: How, if at all, should the definition of *covered transaction* be modified with respect to the conversion of a contingent equity interest or convertible debt? What are the considerations as to the balance among minimizing compliance costs, avoiding over- or under-inclusiveness, while maintaining U.S. Government visibility into the instances of conversion?

§850.210(2) includes as a covered transaction, a U.S. person's provision of debt financing where such debt financing is convertible to an equity interest. We recommend that Treasury revise this provision to specify that it includes only a transaction in which the borrower/issuer receives proceeds from the transaction. In addition, we recommend clarification that secondary market transactions (i.e., a transfer of debt from an existing holder to a new holder) are not within the scope of the implementing regulations as such transactions would not result in any additional proceeds to the borrower/issuer.

We also recommend that the provision of debt financing to a covered foreign person (where such debt financing is convertible to an equity interest) only qualify as a covered transaction if the convertible debt *automatically* converts to equity upon the occurrence of a specified event. In the scenario of a convertible bond that only converts upon the occurrence of an exercise of rights by a U.S. person, the definition of covered transaction should capture only the exercise of that right (i.e., the actual acquisition of equity), and not the provision of the original debt financing.

VI. Definition of Covered Transaction

Question 7: Are there adjustments to the types and scope of *covered transactions* identified in the proposed rule (including addition(s), removal(s), or elaboration(s)) that should be made to help ensure it addresses the national security concerns identified in the Outbound Order and discussed above while minimizing unintended consequences? If so, what are they?

<u>Follow-on transactions</u>

We recommend that Treasury except from §850.210 any follow-on transactions resulting from existing investments. For example, if an original transaction that was either not a covered transaction or that was an excepted transaction is restructured, the restructured investment should

be excepted. By their nature, the timing and terms of a follow-on investment are not known at the time of an initial investment. Restricting the ability of U.S. persons to participate in follow-ons could economically harm U.S. persons by reducing the value of otherwise permissible investments and negatively impacting their ability to protect their capital during the lifecycle of a given investment. For example, a situation may arise in which an investee company goes into distress and additional funding is needed as a temporary stop gap measure. Rather than losing all of the funds invested in such entity, it may be in the best interest of the investor (whether a U.S. person or a client of a U.S. person), to provide additional funding.

VII. Due Diligence and Compliance Burden

Question 3: What considerations should the Department of the Treasury take into account with respect to the ease or difficulty with which a U.S. person will be able to comply with the proposed rule, particularly with respect to ascertaining whether an investment target or relevant counterparty is a person of a country of concern and engaged in a covered activity?

All reasonable steps

Under §850.302, U.S. persons are obligated to take "all reasonable steps" to prohibit and prevent transactions by a controlled foreign entity that would be prohibited if engaged in by a U.S. person. The term "all reasonable steps" is overly-broad and would impose an unachievable standard. This standard would result in needless second guessing, even when significant efforts were made to comply. Instead, we request that Treasury instead require U.S. persons to take "reasonable steps." The removal of the term "all" would, in our view, impose a realistic and achievable obligation upon U.S. persons, while addressing Treasury's objective of limiting the likelihood that a controlled foreign entity would engage in a covered activity.

Due diligence and compliance burden

As proposed, the U.S. outbound investment program will significantly enhance the amount and type of due diligence that U.S. persons will need to undertake when considering investing in non-excepted securities or otherwise entering into a business arrangement with a non-U.S. person. Because of the breadth of the definition of person of a country of concern and covered activity, this enhanced level of diligence will need to be undertaken not only with respect to persons that are clearly or likely a person of a country of concern, but, in practice, on each and every person globally.

For our members – regulated fund and asset managers – such assessments would need to be performed not only with respect to their own potential business relationships and arrangements, but also with respect to the regulated funds and investment accounts that they manage as fiduciaries on behalf of clients. These funds and investment accounts cover a wide range of investments and

strategies, including, for example, index-based strategies such as S&P 500 index funds, and actively-managed funds, such as emerging markets debt and equity funds. These funds and accounts are often invested in the securities of hundreds if not thousands of entities. For our members, these investments are primarily (though not exclusively) in publicly traded securities. As a result, the retainment of the exception for publicly traded securities and the precise parameters of that exception will have a significant impact on the ultimate magnitude of the compliance burden for our members.

We describe below how compliance with the U.S. outbound investment program could impact the portfolio management activity of our members, and how it would differ from the programs that our members have already implemented to comply with existing sanctions and related programs. Based on discussions with our members, we understand that the due diligence they would need to perform to make the determination regarding whether an investment target or relevant counterparty is a person of a country of concern and engaged in a covered activity will be complex and time-consuming and include a new, manual compliance process. The current sanctions and related programs to which U.S. persons are subject that prohibit or restrict relationships with or investments in foreign persons are predicated on the provision of a list of foreign persons within scope or are otherwise clear in jurisdictional scope. Depending on the program, the prohibitions may apply only to the foreign person specified, or also to certain of the foreign person's affiliates. In either case, the U.S. government provides specific information on the foreign persons that are in scope. Based on this specified list, it is clear to U.S. persons with whom they can or cannot transact.

Because there is relative clarity under the existing programs regarding the foreign persons in scope, our members are currently able to utilize automated processes that prevent investment professionals from inadvertently trading in restricted securities because they apply a list of persons and/or securities with whom transactions are restricted. Some firms use proprietary systems to create and maintain such lists, whereas other firms may additionally or exclusively use third-party products to assist with compliance. Currently, even in circumstances where a foreign person's affiliates are not specifically listed by the U.S. government, but are otherwise pulled into scope, our members are able to utilize lists that are generated to include such affiliates. By contrast, in relying on U.S. persons to identify covered foreign persons, the U.S. outbound investment program as proposed by Treasury would operate in a completely different manner that would not readily accommodate the use of automated systems.

As a first step, our members would need to evaluate whether a security is issued by a person of a country of concern or an in-scope parent of such person. The scope of the definition is very broad. For example, as contemplated, a person of a country of concern would include a UK-domiciled private company in which a Canadian citizen that is a permanent resident of Hong Kong holds greater than a 50 percent ownership interest. Coming to a definitive conclusion on

each prospective investment regarding whether that investment would be in a security issued by a person of a country of concern would require our members to understand the ownership structure and beneficial owners of entities in a level of detail that is much more granular than what is typically assessed. Further, the information needed to make such determinations may not be publicly available and foreign persons may be reluctant to provide it for various reasons, including privacy concerns.

Secondly, our members would need to conduct detailed diligence on the current and expected business activities of an entity, including with respect to all business lines no matter how material to the entire business, to determine whether the entity's activities include covered national security technologies or products. The diligence they would need to perform differs significantly from, and would be much more detailed than, their existing investment research process which is typically focused on an entity's financials, general operations, and other features relevant to that type of investment or client. Performing such extensive due diligence may be complicated further by restrictions or obstacles imposed by certain foreign governments. Further, due to the potentially complex nature of the technologies and products in scope, our members will likely need to hire or retain technical experts to perform the necessary level of diligence in order to make an assessment.

As part of the investment process, our members may utilize third-party lists that classify entities into certain industry-standard sectors or sub-sectors, such as Global Industry Classification Standard (GICS) and Industry Classification Benchmark (ICB). In this circumstance, such lists would have extremely limited, or no, utility because (1) the classification system does not include categories that match those identified by Treasury, and (2) the classification is applied to a limited range of securities and would generally not include the non-publicly traded securities potentially in scope of the program.

The time and labor-intensive due diligence process described above would be magnified exponentially if the exception for publicly traded securities was removed. In that case, due to the broad scope of the definition of person of a country of concern (and the inclusion of subsidiaries in the definition of covered foreign person), extensive due diligence would need to be performed on each and every investment globally.

A de minimis exception, as we have recommended above, would greatly ease the compliance burden, while, in our view, providing adequate protections for the U.S. government's concerns.

VIII. General Relief for Reasonable, Good Faith Compliance

As stated above, our members are committed to developing the necessary compliance procedures and operational processes needed to comply with the U.S. outbound investment program. There, however, will be a multitude of judgments they will need to make regarding the identities and

activities of potentially complex foreign companies. Accordingly, in addition to guidance on the specified provisions described above, we urge Treasury to provide general relief for good faith compliance efforts. In particular, we request that Treasury confirm that, in the absence of specific guidance, U.S. persons can rely on reasonable, good faith interpretations of the requirements under the implementing regulations for the U.S. outbound investment program.

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We appreciate your consideration of our comments. If you have any questions or would like to discuss our comments further, please contact Matthew Mohlenkamp (matthew.mohlenkamp@ici.org) or Eva Mykolenko (emykolenko@ici.org).

Sincerely,

/s/ Matthew Mohlenkamp

Matthew Mohlenkamp
Managing Director,
Asia and Global Analytics

/s/ Eva Mykolenko

Eva Mykolenko
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Securities Regulation