



October 17, 2019

Via www.regulations.gov (Docket Nos. TREAS-DO-2019-0008)

The Honorable Thomas Feddo
Assistant Secretary for Investment Security
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Re: Comments of the Securities Industry and Financial Markets Association on the Proposed Rule Regarding Provisions Pertaining to Certain Investments in the United States By Foreign Persons

Dear Mr. Feddo,

The Securities Industry and Financial Markets Association (“SIFMA”) appreciates the opportunity to comment on the Proposed Rule Regarding Provisions Pertaining to Certain Investments in the United States By Foreign Persons issued on September 17, 2019 by the Department of the Treasury’s Office of Investment Security (the “Proposed Rule”).¹ SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the United States and global capital markets. On behalf of nearly one million industry employees, SIFMA advocates on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. SIFMA serves as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency.

SIFMA supports the important role that the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) plays in protecting U.S. national security. Because our members are regularly involved in transactions subject to CFIUS’s jurisdiction, we also have an interest in ensuring that the Committee operates within timelines that are consistent with business realities, and that the rules governing the process are clear and unambiguous. Further, because the CFIUS process is likely to be a model for other countries

¹ 84 Fed. Reg. 50174 et seq. (to be codified at 31 C.F.R. pt. 800).

that are developing their own foreign investment screening procedures — to which U.S. investors may be subject — we have an interest in ensuring that the process remains grounded in fundamental principles of fairness and due process, and imposes no greater restriction on foreign investment than is necessary to protect U.S. national security. To that end, our comments address five aspects of CFIUS’s authority under the Proposed Rule: (i) the definition of “U.S. business;” (ii) the scope of mandatory filings under the critical technology Pilot Program (the “Pilot Program”);² (iii) the declaration process; (iv) the treatment of investment funds; and (v) the application of mandatory filing requirements in debt transactions.

1. CFIUS should clarify that the Committee’s jurisdiction does not extend to businesses having no assets in the United States

We are concerned that the proposed definition of U.S. business set forth at § 800.252 of the Proposed Rule suggests that CFIUS may seek to assert jurisdiction over transactions involving businesses with no U.S. assets. The scope of CFIUS’s jurisdiction is broad, but it also has long been a core principle of applicable law and policy that there must be a “U.S. business.” While the term “U.S. business” has been interpreted expansively in some instances, there always has been a requirement that there must be some assets in the United States to constitute a U.S. business.

The definition of U.S. business in the Foreign Investment Risk Review Modernization Act (“FIRRMA”), and now in the Proposed Rule, raises the spectre that CFIUS may intend to deviate from this core principle. Under the existing regulations, “U.S. business” is defined as “any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States, *but only to the extent of its activities in interstate commerce.*”³ The Proposed Rule omits this important qualifying language. While the Proposed Rule provides a single example that appears to narrow the scope of the term — indicating that a foreign business that sells products into interstate commerce is not a U.S. business — this one example does not cover many other foreign businesses, such as service providers, that could for the first time be swept within CFIUS’s jurisdiction.

To resolve the uncertainty created by the Proposed Rule, CFIUS should retain the existing definition of U.S. business in the current regulations, or otherwise clarify through further examples that a business that has no assets in the United States is not a “U.S. business.” In particular, CFIUS should ensure that the regulations are clear that foreign businesses with no U.S. assets that provide services, or bundled products and services, to U.S. customers — or that otherwise participate in U.S. interstate commerce without having assets in the United States — are not U.S. businesses.

² 31 C.F.R. pt. 801 (2018).

³ 31 C.F.R. § 800.226 (2008).

2. CFIUS should narrow the scope of the mandatory filing requirements for critical technology businesses

The Pilot Program for the first time imposed mandatory filings on a broad range of transactions involving “critical technology” businesses. CFIUS chose to apply those requirements to all “foreign persons,” effectively regulating to the fullest possible reach of the Committee’s authorities under FIRRMA. In doing so, the regulations imposed new filing obligations not only on a broad range of trusted investors from allied countries, but even to some U.S. companies with minority foreign ownership.

The Pilot Program requirements also are ambiguous in certain key respects. Mandatory filing obligations apply to all “foreign persons” which is defined to mean not only any “foreign national, foreign government, or foreign entity” but also “any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity.”⁴ “Control” for CFIUS purposes is expansively defined to include the ability of the investor to determine, direct or decide important matters.⁵ “Control” accordingly is a flexible concept that depends on the facts and circumstances of a particular transaction. The ambiguity inherent in the control standard, which is a legacy of CFIUS’s long-standing voluntary filing regime, becomes highly problematic in a mandatory filing regime, especially when combined with the extraordinarily broad application of the Pilot Program.

CFIUS should narrow the scope of mandatory filings for critical technology businesses by, at minimum (i) excepting from the filing requirements a class of trusted investors, leveraging an expanded concept of “excepted investor” as described below, and (ii) exempting U.S. businesses whose sole involvement with critical technology is the use of certain non-sensitive encryption.

First, CFIUS should adopt more inclusive definition of “excepted investor,” and also exempt those parties from the scope of any mandatory filing requirements. FIRRMA requires CFIUS to prescribe regulations that further define the term “foreign person” for purposes of CFIUS’s areas of expanded jurisdiction.⁶ The purpose of this provision, as we understand it, is to ensure that CFIUS’s new authorities do not unnecessarily burden investment from allied countries that are unlikely to present national security concerns. In the Proposed Rule, CFIUS has implemented this requirement through the concept of “excepted investors,” which in turn is tied to a list of “excepted foreign states.”⁷ The requirements to be an excepted investor are quite strict: the investor must not only be headquartered and domiciled in an excepted foreign state or the United States, but also must satisfy other requirements, including that (i) each and every member or observer on the investor’s board be a citizen either of the United States or of an excepted foreign state, and (ii) every individual shareholder with greater than a five percent interest be a citizen of the United

⁴ 31 CFR § 800.216 (2008).

⁵ 31 CFR § 800.204 (2008).

⁶ 50 U.S.C. § 4565(a)(4)(E) (2018).

⁷ 84 Fed. Reg. 50174 § 800.219-20 (proposed Sep. 17, 2019) (to be codified at 31 C.F.R. pt. 800).

States or an excepted foreign state. Based on these criteria, we anticipate that the universe of excepted investors will be exceedingly small.

CFIUS should implement a more inclusive definition of excepted investor that encompasses trusted parties from allied countries who may not satisfy the exacting criteria comprising the current definition of excepted investor. In this regard, we submit that the five percent standard for foreign ownership is unnecessarily low as well as inconsistent both with CFIUS practice and the balance of the Proposed Rule, which uses the standard of “control” or certain defined rights to determine whether foreign ownership presents any national security concerns. To that end, CFIUS instead should apply a 20 percent standard for foreign ownership. Also, in order to circumscribe more appropriately the scope of mandatory filings, CFIUS should expand the benefits afforded to excepted investors by exempting those parties from mandatory filing requirements.

Second, CFIUS should exercise its discretion not to mandate filings for transactions involving U.S. businesses whose only connection to critical technology is the use of certain ubiquitous encryption that, while widely utilized and not sensitive, nonetheless is technically classified as a critical technology under the Export Administration Regulations (“EAR”) and FIRRMA. Specifically, CFIUS should not require mandatory filings for U.S. business whose only involvement in critical technology is the development of software that is eligible for broad export and reexport under License Exception ENC found at 15 C.F.R. § 740.17(b). At a minimum, mandatory filings should only be triggered by development of software described by the following paragraphs of Section 740.17(b)(2) – paragraphs (i)(B) through (i)(F), and paragraph (ii), (iii), and (iv). By limiting required filings to items not eligible for License Exception ENC, or only for a subset of the most sensitive items eligible for that license exception, CFIUS would focus any mandatory filing requirement on truly critical sensitive encryption technology that is currently subject to tighter export controls, rather than ubiquitous, non-sensitive encryption technology.

Scaling back the scope of mandatory filing requirements for U.S. businesses involved only with non-sensitive encryption will be especially critical if CFIUS elects to eliminate the “Pilot Program industry” requirement, as set forth at 31 C.F.R. § 801.212. If the industries prong of the criteria for being a critical technology business were removed, we expect that a broad range of non-sensitive financial technology companies would be newly classified as “pilot program U.S. businesses” on the basis of their use of encryption technology. Those businesses are not captured by the Pilot Program now because they have no activities in, and do not develop any products for use in, any of the 27 Pilot Program industries. In turn, even investors from allied countries — and indeed even “excepted investors” — would be required to file with CFIUS before undertaking investments in those companies. This would discourage foreign investment in such companies, which would appear inconsistent with other U.S. government initiatives, such as SelectUSA, that seek to foster foreign investment in such companies.

3. CFIUS should ensure that the declaration process provides a meaningful path to approval

FIRRMA expanded CFIUS's jurisdiction to reach a far broader range of transactions, and also extended the timelines for CFIUS reviews. At the same time, FIRRMA compensated for these changes by establishing the "declaration" process, which is intended to be a streamlined filing process, allowing less sensitive and simpler transactions to be approved more rapidly. We understand, however, that in practice CFIUS has affirmatively approved only a small minority of transactions through the declaration process to date, and in a larger percentage of cases has requested that the parties submit the more expansive traditional full notice. For those transactions, the declaration process inadvertently has *increased* the time for parties to secure CFIUS approval by adding the 30-day declaration process at the beginning of a formal review of a full notice.

In our view, it is essential that transaction parties have confidence that non-sensitive transactions will be approved within the 30-day declaration period. If the Committee is unable regularly to approve low-risk transactions within the declaration period, the declaration process will become unattractive to transaction parties and its purpose will be defeated. CFIUS should make every effort, consistent with its obligations to protect U.S. national security, to approve declarations and grant the legal safe harbor to parties at the end of the 30-day period.

4. CFIUS should clarify the applicability of the regulations to investment funds

FIRRMA and the Pilot Program regulations both include important and helpful language clarifying that foreign persons may invest as passive limited partners in investment funds without triggering mandatory filings for the fund or the foreign limited partners, provided that certain requirements are met.⁸ This is a helpful confirmation that the Pilot Program is not intended to encompass standard passive limited partner investments in funds that themselves are not otherwise foreign persons.

Nevertheless, the Pilot Program introduced uncertainty for investment funds because it relies on a definition of "foreign person" that is somewhat ambiguous when applied to common fund structures. CFIUS should clarify the definitions of "foreign entity" and "principal place of business" to confirm that CFIUS's authorities do not apply to investment funds that are controlled by U.S. persons, even if those funds or the general partners thereof are domiciled in foreign jurisdictions such as the Cayman Islands.

5. CFIUS should clarify and address the application of mandatory filing requirements to debt transactions

The Pilot Program and the Proposed Rule require parties to notify certain transactions to CFIUS at least 30 or 45 days before completing the transactions or face civil penalties. While these requirements are

⁸ § 31 C.F.R. 801.304 (2018).

manageable in negotiated transactions, they are problematic in the context of lending transactions, where foreign lenders may find themselves in the position of acquiring title to assets when a debtor has defaulted, before the lender is able to comply with mandatory filing requirements. In many circumstances, lenders will not be in control of when they receive equity in a business because they do not control the timing of the borrower's bankruptcy.

CFIUS should establish an exception to the notification requirement for mandatory declarations, providing either that lenders are not required to submit a declaration following a transaction involving a default on a loan, or that in those circumstances the parties are required to file as soon as practicable.⁹ In the event CFIUS decides to require mandatory filings for such transactions, the Committee should, at a minimum, exclude debt transactions from triggering civil penalties. Considering the large sums of money often involved in lending transactions – by comparison to, for example, many venture capital-type minority investments – civil penalties tied to the value of the transaction could be extraordinarily punitive, especially where the timing of the equity conversion is not within the lender's control. As currently drafted, the Proposed Rule could unintentionally create a disincentive for foreign financial institutions to lend to U.S. businesses, and especially critical technology businesses, which in turn would deny those companies a critical source of capital to fund research and development and other operations.

* * *

Thank you for the opportunity to provide these comments.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ken Bentsen". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Kenneth E. Bentsen, Jr.
President & CEO

⁹ Such an exception would be consistent with other debt to equity regulations. For example, pursuant section 4(c)(2) of the Bank Holding Company Act, a bank holding company is not required to seek prior Federal Reserve Board approval before acquiring voting securities or assets through foreclosure or otherwise in the ordinary course of collecting a debt previously contracted. 12 U.S.C. § 1843(c)(2).