September 28, 2023

Via www.regulations.gov

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

Re: National Venture Capital Association Comments on Advance Notice of Proposed Rulemaking RIN 1505-AC82, Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern (88 FR 54961) (the "ANPRM")

Dear Ms. Sharma:

The National Venture Capital Association ("NVCA") appreciates this opportunity to submit comments on the ANPRM, which proposes the implementation of a regime that would restrict U.S. capital outflows to certain Chinese, Chinese-owned, or otherwise China-related parties in certain specific industries. Our comments discuss several open questions related to that implementation.

NVCA has a diverse membership base of venture capital firms and corporate venture capital groups spread across the country, investing both inside and outside the U.S. The role of those venture capitalists is to invest and partner with high-growth startups with transformative ideas to power innovation and our economy. Investments from member funds fuel U.S. entrepreneurship, jobs, technological leadership, and ultimately national security.

With that mission in mind, NVCA submits these comments (the "Comments") to provide feedback to the Department of the Treasury ("Treasury") on how best to ensure that the final implementation of the proposed rules contemplated in the ANPRM address national security concerns while minimizing disruption to America's vibrant and vital venture capital community.

Introduction to NVCA Comments on the ANPRM

The ANPRM is the first step in implementing Executive Order 14105, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (the "Order"). The Order directs Treasury to issue regulations that describe transactions involving U.S. persons investing in certain technologies, where such technologies are built by entities involved with certain "countries of concern" (specified as China, Hong Kong, and Macau). The regulations would then

either (a) require the U.S. persons to notify Treasury of those transactions or (b) prohibit those transactions.

NVCA supports the stated concern that the ANPRM mentions as underpinning the Order – i.e., preventing the "transfer of intangible benefits" that may accompany U.S. capital, when such intangible benefits could support the development of technology with military end uses in countries of concern. Most NVCA members are U.S. venture capital funds managed by U.S. persons, and would never seek to accelerate the progress of military development in countries of concern.

However, NVCA believes it is critical to elucidate the set of "intangible benefits" that are of concern to Treasury. For example, a semiconductor fabrication facility investing billions in a new fabrication joint venture is highly likely to carry intangible benefits related to the development of the related technology. A venture investor putting $500K into a seed-stage startup, by contrast, would be more likely to provide intangible benefits in the form of, e.g., business coaching and introductions to other investors. Moreover, as discussed in more depth in the comments that follow, there also may be national security drawbacks involved in an overbroad set of restrictions on outbound investment.

In brief, NVCA has two overarching concerns: First, if the rules are promulgated on the terms proposed by the ANPRM, they are likely to create significant cost in cases where that cost brings effectively no national security benefit. Second, the ANPRM proposals and definitions do not provide the requisite clarity to enable investors to understand which investments should be notified or must be prohibited. NVCA believes that some targeted changes can help ensure that the forthcoming rules do not deter investment in key sectors of the U.S. economy, and submits these Comments with the intention of addressing those concerns.

Before describing a few key proposed changes to definitions in the ANPRM, NVCA commends Treasury for its consideration of the venture community to date. Treasury has made a substantial effort to narrow the scope of the technology sectors to which the final rules will apply. Ultimately, NVCA hopes to work with Treasury both to clarify ambiguities and points of confusion in the final regulations and to rebalance selected aspects of the ANPRM to ensure that national security is protected and adverse economic and national security consequences are avoided.

Issue 1: If the definitions in the ANPRM are not clarified, the rules will create a significant diligence burden for U.S. investors, which will impact a far broader range of investments than the narrow set to which the rules ostensibly will apply.

The ANPRM proposes definitions of "covered foreign person," "covered transaction," and various types of "covered national security technologies and products," the last of which in turn are used to define the former two terms. It then asks, in Questions 5 and 11, whether there are potential unintended consequences from these definitions, such as "impacts on U.S. persons and U.S. investment flows."

The unintended economic consequences of these various definitions will be significant. Treasury states in the ANPRM that the new regime is "not intended to impede all U.S. investments into a country of concern or impose sector-wide restrictions on United States person activity" (ANPRM Section II). However, given the nature of the rules the ANPRM proposes – i.e., legal prohibitions on investment activity – they will inevitably establish a set of facts that U.S. investors will have to assess for every active investment they make. Specifically, venture investors will need to confirm that each company they invest in either (a) does not work with technologies or products in the covered categories or (b) is not located in China, does not act under the control or at the behest of the Chinese government, and is not subject to a 50% or greater ownership interest from investors from China.

NVCA member firms are well aware of this issue in a CFIUS context, where the need to engage in basic foreign investment diligence requires their portfolio companies to assess whether every non-passive investor is or is not foreign. That in turn has inevitably created economic tradeoffs that has limited those companies' ability to raise capital. These *new* rules, if established under the ANPRM's definitions, will impose a similar broad-based diligence obligation on venture investors themselves. In fact, because there is no passivity exception currently proposed in the ANPRM rules for venture investors (see Issue 2), the diligence requirement will in fact be even broader in this case. Even though in the vast majority of cases the answer will come back "no, we're not in those sectors" or "no, we have no Chinese ownership," venture investors will need to ask all companies these questions and assess the answers. This in effect will serve as a regulatory tax on U.S. venture investors, making each investment that much more expensive and so limiting the capital available to U.S. innovators.

NVCA understands that Treasury expects diligence to be a key cog in this new regulatory machine: in the context of its proposal of a knowledge standard, the ANPRM presupposes that investors will engage in "a reasonable and appropriate amount of due diligence" (ANPRM Section III.J). And to be clear, NVCA members stand prepared to engage in such diligence where the possibility of investing in a manner that supports Chinese military priorities is a realistic one. However, to the extent that (a) technologies or products in the covered categories are not crisply defined or (b) determining which parties are acting at the behest of the Chinese government are subject to a 50% or greater Chinese ownership interest requires the assessment of facts that are not easily determined, such as indirect passive interests held by Chinese parties, the tax may be significant and will be imposed even in tens of thousands of investments where the connection to Chinese national security advancement is non-existent.

<u>*Proposed solutions*</u>. NVCA suggests that in order to limit the costs imposed on investors, Treasury must define all three of the covered categories and the scope of a "person of a country of concern" in as clear a set of terms as possible to simplify the act of assessing which investments are prohibited or notifiable. The further issues discussed in the next few sections of these Comments speak to certain specific changes that NVCA should consider in that regard.

In addition, to limit the legal overhead associated with the diligence exercise, Treasury should establish a set of Treasury-approved standard representations that indicate what specific factual warranties must be provided for an investor to have confidence that an investment is outside the scope of the regime. In the CFIUS context, NVCA itself has established market-standard representations for foreign investment into the U.S., which have simplified the venture investment diligence process in relevant cases. However, Treasury's imprimatur on such representations would provide added market certainty. If Treasury would be open to incorporating examples of acceptable representations for this new outbound investment screening, NVCA would be willing to provide and discuss such examples once the proposed rules are published. The inclusion of examples that describe standard, Treasury-accepted representations in the final regulations would help lessen the diligence burden on venture investors and innovators alike.

Similarly, again with the goal of limiting the legal overhead, Treasury should provide a sample diligence question set that investors can solicit responses from target companies. Both in Question 7 and throughout the ANPRM, Treasury asks industry for input on the types of due diligence that investors might perform to understand whether they are potentially entering into a prohibited investment. However, investors will have difficulty providing useful responses without a better sense of Treasury's expectations in that regard, particularly the degree of confidence that Treasury requires investors to have as to whether a transaction would or would not be subject to the outbound rules. If Treasury can offer sample diligence questions as part of the set of examples provided in the proposed rules, venture investors would then have a basis upon which to comment on the practicality of pursuing such questions in a venture context, and possibly to offer alternatives.

Issue 2: Establishing a "passivity" exception only for LPs disadvantages U.S. funds in the global battle for LP capital; that exception should be clear and universal.

The ANPRM proposes to establish a category of excepted transactions that includes a passive limited partner exception. Under that exception, LPs in funds – subject to certain potential yet-to-be-defined limits on the rights of the LP and the size of the investment – would not be subject to the application of the outbound investment rules. The ANPRM then asks, in Questions 20, 21, and 22, whether there are potential unintended consequences from this definition, such as "impacts on U.S. persons and U.S. investment flows," whether this LP exception is appropriately scoped, and whether any other types of investments should be considered as excepted transactions.

NVCA anticipates that the proposed LP exception would significantly disadvantage U.S. venture capital funds in seeking to raise capital from both U.S. and foreign limited partners. The market for LP capital is both fierce and global – funds all over the world chase a limited number of LP dollars. In doing so, funds advertise various attributes to LPs, including, e.g., low operating costs and broad-based investment strategies. However, if these rules are put in place, foreign funds in Europe, China, and elsewhere would start making two arguments to LPs regarding their advantages when compared to U.S. funds: First, these foreign funds will note that they are able to invest in the most exciting companies in covered technology categories, no matter who the founders are or where they're located, providing LPs more complete exposure to the market. Second, these foreign funds will tout their ability to avoid the costs mentioned above in Issue 1 – costs U.S. funds would have to pay to ensure their investments are not covered by the outbound investment rules – resulting in LPs obtaining an incrementally better return on investment.

Whether at the LP level or the fund level, the passive investment exception should also be rooted in clear, easy to understand guidance on permitted and prohibited investment sizes and rights. In Question 22, the ANPRM discusses the possibility of tests based on "one or more factors such as the size of the U.S. limited partner's transaction, and/or the total assets under management of the U.S. limited partner," on the theory that larger dollar values and bigger names convey "the enhanced standing and prominence that may be associated with the size of the transaction or the investor, and increased likelihood of the conveyance of intangible benefits to the covered foreign person." NVCA suggests that tests based around dollar value are unhelpful, given the vastly differing levels of investment startups may receive, and that the inchoate nature of prestige-based tests is even harder to address. Instead, Treasury should build the final rules to address concepts that bear directly on the likelihood and opportunity that investors have to provide intangible benefits to portfolio companies, as explained below.

Proposed solutions. A simple addition to the excepted transactions list, rooted in Treasury's own justification for the LP exception, could help U.S. venture funds remain more competitive against their foreign counterparts. Treasury's primary thesis for including venture capital investments in the APRM appears to be that "U.S. investments are often more valuable than capital alone because they can also include the transfer of intangible benefits" (ANPRM Section I). However, in discussing the proposed excepted transactions definition, Treasury appropriately describes the "objective of [the LP exception, *inter alia*] is to carve out certain transactions that are unlikely to involve the transfer of both capital and additional benefits to a covered foreign person" (ANPRM Section III.E). It also states that "[t]he rationale for [limiting the exception's application to investments below a certain size and rights threshold] is that transactions above a threshold are more likely to involve the conveyance of intangible benefits" (*Id.*)

The logic of these statements applies with equal force not just to LP investments but also to direct venture investments that are similarly made below a certain size and rights threshold. If Treasury is concerned about the sharing of intangible benefits, it should make that concern explicit and place the passivity exception at the investor level rather than the LP level. Instead of privileging limited partner status,

Treasury should except investments from *any U.S. investor* that is making a small investment that does not exceed a certain percentage of outstanding shares (e.g., 10%) or grant it any rights in the target company. In other words, U.S. venture funds would have the option to choose to either (i) make a passive investment and not share any knowledge or other intangible benefits with investee companies, in the manner suggested by the proposed LP exception, or (ii) make an active investment and operate under the outbound investment restrictions.

This change would allow U.S. funds to indicate to LPs that they are more similarly situated to foreign funds in their ability to invest in emerging technologies, wherever those technologies emerge. Without this change, much of the same LP capital will still reach many of the same Chinese companies (via foreign venture funds) without U.S. funds being able to obtain a corresponding understanding of the state of the international market in these technological areas.

Whether at the LP level or the fund level, NVCA suggests that the test for excepted passive investment should be based around two questions: First, will the fund – or the LP investor, as the result of the fund investment – obtain any rights that would require or allow it to become involved in the target company's decision-making and thus potentially convey any intangible benefit? For example, board rights, observer rights, or management consultation rights for the U.S. investor would all potentially be impermissible. However, rights to obtain the one-way sharing of information *from* the portfolio company (and in the case of U.S. LPs, from the fund) regarding its financial performance, technical developments, etc., should be permitted. And second, will the fund (or indirectly, the LP investor) actually hold a majority economic share of the portfolio company such that it is constructively in control of its operations and decision-making even if the formal rights mentioned above are absent?

This two-question test would apply equally well to an LP investor's direct rights in a fund, a fund's direct rights in a portfolio company, or an LP's indirect rights in that company. For example, if Treasury has concerns about the level of influence exercisable by the LP over the fund and the indirect implications that might lead to the acquisition of intangible benefits by the ultimate investee company, then limiting active involvement and capping ownership in the fund provides strong evidence that no relevant interactions between the LP investor and the fund – and thus certainly not the LP investor and the investee company – are occurring. An approach focused on assessing whether an investor has an affirmative answer to either of these two questions – at the LP or the fund level – would remove the threat of conveyance of intangible benefits while providing clear, administrable guidance to investors.

Issue 3: The extraterritorial definition of "covered foreign person" will disincentivize the founding of the next generation of AI, semiconductor, and quantum computing businesses in the U.S. and allied nations.

The limitations on investment established under the ANPRM apply to covered foreign persons, a group which in turn is defined by reference to a set of "person[s] of a country of concern." Ultimately, the proposed definition of person of a country of concern in the ANPRM would restrict investments into a number of distinct types of China-associated businesses. Among them would be (A) companies in the U.S. founded by student visa holders from China, (B) companies outside the U.S. founded by local permanent residents who are Chinese nationals, (C) companies anywhere in the world with 50% or more Chinese ownership, and (D) any entity anywhere "owned, controlled, or directed by, or acting for or on behalf of" the Chinese government. The ANPRM asks, in Questions 3, 5, 6, and 7, whether Treasury should further elaborate upon this definition, whether there are potential unintended consequences from this definition, such as an impact on U.S. persons and U.S. investment flows, and whether this is a useful test, including in a diligence context.

NVCA anticipates that the proposed definition would harm both the U.S. and allied nations' ability to attract talent from China by making it more difficult for U.S. venture investors to invest in businesses being founded in U.S. and allied nations by, e.g., students from China. As Treasury is no doubt aware, a significant amount of technical talent arrives in the U.S. and allied nations from China, including talent in the specific covered technological areas. As National Security Advisor Jake Sullivan said in 2021 at the National Security Commission on Artificial Intelligence Global Emerging Technology Summit: "With a population of 1.4 billion people, China graduates four times as many STEM college majors as the United States. Still about 9 in 10 AI PhD students from overseas right now take a job in the United States after graduating. We have to keep it that way, and we need to build on that beyond the AI PhD field…"

The rules derived from the ANPRM appear intended to capture categories (A) and (B) above – i.e., companies founded here or in friendly nations by Chinese students or other Chinese nationals – in parts (1) and (4) of the proposed definition. If so, the U.S. will be limiting its own ability and the ability of allied nations to capture that talent and encourage those individuals to found local businesses outside of China in these critical sectors. Moreover, if those Chinese students or other Chinese nationals can be convinced to found businesses in the U.S. or in allied nations, existing laws – e.g., CFIUS and those other nations' foreign direct investment regulatory regimes – would then help protect those companies from Chinese investor and government interference.

Concerns with the proposed "person of a country of concern" definition do not end there. Categories (C) and (D) above are captured by parts (3) and (4) of the proposed definition; if promulgated in their current form, these parts of the definition will create significant uncertainty for investors in determining which investments are covered by the new regime. A U.S. investor generally does not establish any direct contractual relationship with the existing investors in a company in a covered sector when it starts conducting diligence for a potential investment in the company in which those other investors already have stakes. Accordingly, the U.S. investor does not have a mechanism with which to conduct direct diligence on those preexisting investors to determine whether they are (potentially indirectly) under Chinese ownership. It may ultimately be reliant on the target company itself to perform that diligence by going back to its prior investors and asking for additional information. Similarly, even if it *had* the opportunity for direct diligence, determining whether a counterparty is "owned, controlled, or directed by, or acting for or on behalf of" the Chinese government is a difficult information collection problem that U.S. venture investors are ill-equipped to undertake.

<u>Proposed solutions</u>. Treasury should fix the problem with categories (A) and (B) by establishing a greenfield and young startup exception to the definition of "person of a country of concern." As Treasury knows, in the CFIUS context, the greenfield exception is an important protection that ensures that innovative business are founded in the U.S. The need for a similar greenfield exception applies equally here. Indeed, Question 15 asks how "a U.S. person can ascertain whether a greenfield or joint venture investment 'could result' in the establishment of a covered foreign person." The answer should be determined based on level of non-founder ownership and stage of investment. One possible test that NVCA would support: through the first three rounds of equity investment, if more than 50% of the non-founder investors in a business located outside of China are not under Chinese ownership and are not subject to Chinese government influence, the business should not be considered a person of a country of concern. This exception, if embedded in the "person of country of concern" definition, would allow Chinese student visa holders and other Chinese nationals outside China to start raising capital for U.S. or European business and ultimately transition the company to majority non-Chinese ownership.

NVCA also notes in support of this approach that another U.S. government agency recently indicated, while instituting limitations on Chinese business access to sensitive developing technologies, that individual Chinese citizens in friendly nations should be categorized differently and have an important role to play in ongoing innovation. Specifically, in the recent CHIPS Act regulations, NIST drew a

distinction between (a) the level of concern posed by Chinese persons who are actually located in a country of concern like China and (b) those who are working lawfully in an allied state. *See* the definition of "foreign entity of concern" at 15 C.F.R. § 231.104(c)(1)(i).

That fix leaves the problem of (C) and (D) – i.e., how to determine whether a business is under indirect Chinese ownership or subject to Chinese government influence. Here, the rules should provide clear guidance as to how to handle questions of indirect ownership and define what "owned, controlled, or directed by, or acting for or on behalf of" means, precisely – or remove that language. With respect to the former issue, Treasury should establish clear guidance regarding calculating the "indirect" ownership interest – e.g., can passive LP interests be disregarded? Would a 51% Chinese economic interest in a shareholder of a covered business mean that that holder's shares in the business would be treated as 100% Chinese-controlled?

With respect to the latter issue – Chinese government control – the recent definition of foreign entity of concern promulgated by NIST under the CHIPS Act again provides a helpful point of reference. Prong (3) of the "person of a country of concern" definition in the ANPRM uses the phrase "owned, controlled, or directed by, or acting for or on behalf of" the Chinese government. The NIST rules, in turn, use the very similar concept of being "owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country." NIST then defines that concern about foreign government influence as being triggered by four bright line tests: (i) being a citizen of a covered foreign country while in that country, (ii) being a business organized under the laws of that country, and (iii)/(iv) being subject to a certain level of economic interest by that foreign government, state-owned entities, or in-country citizens or businesses (*see* 15 C.F.R. § 231.104(c)). However, the ANPRM definition of "person of a country of concern" *already* covers nearly all of those same bright line tests in prongs (1), (2), and (4). Accordingly, the current ANPRM version of prong (3), covering entities "owned, controlled, or directed by, or acting for or on behalf of" the Chinese government, appears largely redundant if it is intended to cover the same ground as its NIST equivalent.

To establish a set of bright line tests that hews more closely to the NIST approach, Treasury should change the currently ambiguous foreign government control prong such that it uses a numerical economic threshold and specifies "the government of a country of concern, including any political subdivision, political party, agency, or instrumentality thereof, or any entity in whom 50% of the outstanding voting interest, board seats, or equity interest is held directly or indirectly by such a government." This would eliminate the unclear "owned, controlled, or directed by, or acting for or on behalf of" language.

Issue 4: The definition of artificial intelligence is dangerously overbroad.

The proposed definition of "AI system" in the ANPRM includes 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." The ANPRM asks, in Question 42, whether there are any "changes or clarifications that should be made" to this definition and what its "consequences and impacts" may be. Separately, the ANPRM proposes a number of end-use based tests to establish which AI systems will be subject to investment prohibition and notification requirements. It asks in Question 43 how practical this approach is and proposes an alternative approach in Question 46, under which transactions would be restricted based on the involvement of entities "identified on an existing list under a different U.S. Government program that has similar national security underpinnings."

NVCA members view the AI system definition as significantly overbroad. The set of 'engineered systems that generate outputs based on a set of objectives' could be read to include nearly any piece of software. Moreover, the end-use-based limitations that the ANPRM proposes as a way to narrow the set of covered transactions are less clear than they may appear on first review. For example, some U.S.

investors might consider investing in an AI chatbot that can cut down on customer support costs for e-commerce sites by conversing with end-users directly. However, e-commerce sites might well expect that chatbot to record all of its customer conversations for potential future review by human support staff. Would such a chatbot program be considered to be engaged in "mass surveillance," and so be prohibited from receiving U.S. funds under the ANPRM definitions? As another example, a robotic metal punch might be designed with software that uses machine learning to decide how much pressure to use to punch through an aluminum sheet. Would such a program be considered to "control" that robotic system, and as such would investment into that company require notification to the U.S. government?

Proposed solutions. First, Treasury should create a clear definition of artificial intelligence and/or AI system. While NVCA understands that the current definition is drawn from the definitions in the OECD values-based principles for the responsible stewardship of trustworthy AI, NVCA respectfully submits that the vagueness of the definition is inappropriate for prescriptive regulations. Instead, NVCA would propose a definition that requires a product to fit within market definitions of AI – i.e., those that investors use in considering the issue – and in particular those that are intended to replicate the functioning of a human neural system in some capacity.[1]

Second, Treasury should create a more administrable approach, as suggested in Question 46, by establishing a prohibition on investment into AI systems developed by parties on existing government lists of parties of concern rather than focusing on end-uses. By focusing on specific *users* rather than *uses*, Treasury will draw significantly clearer lines as to which AI investments are permitted and prohibited. That specificity in turn will meaningfully reduce the burdens on venture investing mentioned above in the discussion of Issue 1. To the extent that Treasury is concerned that no one list of actors of concern covers the full set of concerning investment targets, the ultimate list could include a compilation of several lists maintained by the U.S. government. For example, in § 231.104 of the CHIPS Act rules, NIST establishes that entities of potential concern include those:

- designated as foreign terrorist organizations by the Secretary of State under section 1189(a) of title 8;
- included on the list of specially designated nationals and blocked persons maintained by the Office of Foreign Assets Control of the Department of the Treasury;
- alleged by the Attorney General to have been involved in activities for which a conviction was obtained under various specific statutes;
- included on the Bureau of Industry and Security's Entity List;
- included on Treasury's list of Non-SDN Chinese Military Industrial Complex Companies;
- and so on.

In the alternative, if Treasury prefers an end-use-based approach, it should ensure that the end uses subject to prohibition and notification requirements are both limited and clear. In response to Question 45: sticking with restrictions on investment tied to systems designed "exclusively for" specified end-uses would be important to maintain clarity. If Treasury were to use the language "primarily for" rather than "exclusively for," that vaguer "primarily for" language would dramatically increase the costs and uncertainty of the diligence addressed in Issue 1. In addition to that point, Treasury should define what is meant by each of the end-uses that it ultimately chooses to list.

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[1] *See, e.g.*, Gartner, https://www.gartner.com/en/topics/artificial-intelligence ("Gartner defines artificial intelligence (AI) as applying advanced analysis and logic-based techniques, including machine learning (ML), to interpret events, support and automate decisions, and take actions."); McKinsey, https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-ai ("Artificial intelligence is a machine's ability to perform the cognitive functions we usually associate with human minds.")

Issue 5: The "knowingly directed" test may create challenges for U.S. funds with loosely affiliated overseas investment teams

The ANPRM limits U.S. persons from "knowingly directing" transactions at foreign funds that would be otherwise prohibited by the rules if performed by a U.S. fund. According to Treasury, this prohibition is currently expected to capture activities such as transactions directed by U.S. person officers or senior managers of those foreign funds (*See* Section III.L). The ANPRM asks, in Question 63, what the "likely impact on U.S. persons and U.S. investment flows" may be.

As background, some U.S. funds are loosely affiliated with foreign funds – e.g., local offices with their own general partners, or even completely independent funds with which the U.S. funds co-invest, based in Europe, South Asia, or East Asia. These foreign funds make independent investment decisions but may discuss those decisions with their U.S. counterparts. The U.S. counterparts may informally discuss foreign funds' potential investments with those funds' principals but generally play no role in those funds' decision-making. NVCA anticipates the proposed definition would cast a shadow on this kind of informal international partnership, for fear of it being deemed "knowingly directing" a transaction toward the foreign team by the U.S. team. This may ultimately cause these funds to separate themselves more completely from their international affiliates and co-investment partners. That separation in turn would disadvantage U.S.-based funds in the race for the best investment talent – i.e., those who can identify exciting new companies in exactly these developing technology sectors where the rules suggest that it is imperative that the U.S. maintain leadership. Those talented investors expect to be able to draw on the global resources of larger firms so that they can bring more capital to bear. It also will make U.S. funds into less savvy judges of the market – cutting U.S. funds off from, e.g., their European offices will only narrow the insight those U.S. funds possess and harm their ability to understand the worldwide state of the market in covered technology sectors.

Proposed solutions. CFIUS should further clarify the difference between (i) individuals who may converse about or who are otherwise indirectly related to a transaction and (ii) individuals who "order, decide, approve, or otherwise cause to be performed a transaction." Treasury in Section III.L provides several examples of scenarios that it does not intend ''knowingly directing'' transactions to cover. In the proposed rules it should expand that list to include, for example:

- "Scenario X: Several U.S. person venture partners assist in the launch of a non-U.S. fund run by independent overseas partners. The foreign fund is not focused on undertaking transactions that would be prohibited if performed by a U.S. person. However, after a few other investments, the fund does make a single investment into a person of a country of concern that would be a prohibited transaction. That investment is not 'knowingly directed' by the U.S. person partners."
- "Scenario Y: A foreign investment fund intends to make an investment into a person of a country of concern that would be a prohibited transaction if performed by a U.S. person. A U.S. person serving on the management committee at a U.S. fund holds a conversation with a counterpart at a foreign fund with which the U.S. fund sometimes co-invests, and in the course of that conversation the counterpart at the foreign fund brings up the planned investment. The U.S. person and U.S. fund have not had any prior relationship to the investment, did not recommend the investment to the foreign fund, and do not have decision-making authority over the foreign fund. The conversation between the U.S. person at the U.S. fund and the counterpart at the foreign fund does not constitute the U.S. person or U.S. fund 'knowingly directing' the foreign fund."

More generally, NVCA would advocate for more examples addressing Treasury's expectations when it comes to the scope of "knowingly directing" fund activity in various scenarios. The inter-fund discussion

issue mentioned above is one very common scenario of potential concern, since funds co-invest regularly, but is also only one of many factual cases that at least some venture funds may encounter that could sit in a gray area. As another example: some U.S. person investment fund professionals work as lawyers, accountants, etc. at foreign-domiciled funds, but are not, e.g., the general partners/decision-makers at those funds. The general partners of such a fund could, for example, approve an investment into a person of a country of concern and ask their U.S. person accountant to wire the money. In Treasury's view, is that scenario closer to Scenario 4 and Scenario 5 in Section III. L of the ANPRM (where the bank that actually wires money and the fund employee who procures real estate unrelated to a particular investment are both not considered responsible for the fund's actions and thus are not obligated to recuse themselves) or more like Scenario 6 (where the U.S. management committee member must actively recuse himself to be considered to have complied with the forthcoming regulations)? The more examples Treasury can provide, the more ready venture capital funds will be to comply with the new rules once issued.