

# U.S. Outbound Investment Regulations: Lessons and Takeaways Six Months In

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The U.S. Outbound Investment Regulations (OIR) entered into force on January 2. Slightly over six months in, now is an opportune time to take stock of how the market is implementing the OIR. As discussed in this Sidley Update, despite sometimes spotty awareness or implementation among investors, the OIR appears to be having its intended effect of reducing U.S. investment in sensitive Chinese technology sectors. Ambiguities in the regulations have broadened their impact, and more changes seem to be coming.

## **The OIR Has Blunted Interest Even in Notifiable Transactions**

As discussed in our earlier Sidley Update [here](#), the OIR prohibits or requires notification of certain investments by U.S. persons or their “controlled foreign entities” (i.e., subsidiaries) in certain Chinese-affiliated companies in the semiconductor and microelectronics, artificial intelligence (AI), and quantum information technology sectors. It also prohibits U.S. persons from knowingly directing investments by non-U.S. investors if such investments would be prohibited if undertaken by a U.S. person.

Notifiable transactions are permissible, and there is no formal approval process required for a notified transaction. A notification is ostensibly only an obligation to share certain information with the U.S. Department of the Treasury (Treasury). We have found that many investors are nevertheless reluctant to undertake notifiable transactions. The reasons vary. Investors might not want to undertake the administrative burden of notifying Treasury; they might not want to attract the attention of the U.S. government as an investor in Chinese technology due to real or imagined fear of political, reputational, or regulatory consequences; they might not want to face questions from Treasury on their investments or ultimate investors; or they might feel that they are putting themselves at risk if Treasury ultimately decides that the investment was actually in the prohibited category, which might result in an enforcement action. Perhaps investors will feel more comfortable with notifiable transactions as time goes on, but, for now, it appears that many investors are holding back from making notifiable transactions.

## **Ambiguities in the OIR Have a Chilling Effect**

The OIR is a first-of-its-kind regulation, but it is not yet a finished product. The January 2 regulations are only version 1.0 — well drafted and much better than a beta test but still glitchy, largely due to ambiguities in the definitions of key terms used in the OIR. Questions remain about whether the

glitchiness is a bug or a feature in the system.

One prime example of this uncertainty arises in connection with the definition of “covered activities.” This term refers to certain activities (development, production, etc.) that a Chinese-affiliated entity (or “person of a country of concern”) might take with respect to one of the designated technology sectors.

Depending on the type of activity, an investment into the covered foreign person may be notifiable or prohibited. However, the distinction between covered activities that fall in the notifiable or prohibited categories is not always clear.

The scope of covered activities specifically related to AI systems is a good example of one of the ambiguities in these definitions. In the prohibited category, the regulations include the “[d]evelopment of any AI system designed to be exclusively used for, or which the relevant ‘covered foreign person’ intends to be used for, any [of a variety of ends uses, including, for example] ... mass surveillance.” The notifiable category covers “[d]evelopment of any AI system that is not described in the prohibited category of AI systems and that is: ... designed to be used for ... mass-surveillance.” Treasury has tried to explain the distinction, but it nonetheless remains difficult to understand and apply in practice.

Treasury has said in an FAQ that “mass-surveillance could be on behalf of a government or not.” Treasury therefore intends to cover investments into companies that design AI systems for nongovernment mass surveillance. It is not clear what nongovernment mass surveillance might capture. For example, are e-commerce or social media companies that create personal profiles of users to feed into their algorithms engaged in private surveillance? In 2024, the Federal Trade Commission issued a report accusing various U.S. and Chinese social media companies of engaging in “vast surveillance.” That report was obviously prepared for a different purpose, but if Treasury were to take a similar approach, the scope of AI systems that would be captured under the OIR would be enormous. We know that the U.S. government has expressed concern that certain Chinese social media companies have been used or could be used for surveillance. At the same time, Treasury has explained that the policy behind the OIR is not supposed to “broadly captur[e] investments into entities that develop AI systems intended only for consumer applications or other civilian end uses with no potential national security consequences.” Where the line should be drawn is not clear.

There are other examples that would illustrate the same point. Despite the attempt to give “covered activities” the appearance of precision, in reality the distinctions that the regulations draw are difficult to apply. Whether by design or not, the consequence has been that many investors are reluctant to take the risk of getting it wrong, and the chilling effect on investment can be quite broad.

### **Administrability Can Be Challenging**

The OIR does not impose strict liability for violations of the regulation. Instead, liability is premised on whether the U.S. person “knew” or had reason to know, after a “reasonable and diligent inquiry,” whether relevant facts and circumstances exist or are substantially certain to occur or are highly probable to exist or occur. As a result, the U.S. person must undertake due diligence when making an investment and must do so for every investment that they undertake. In some cases, whether an investment is within the scope of the OIR may be obvious, and in other cases less obvious. But how much diligence is enough?

Unlike, for example, U.S. sanctions programs, there is no list of covered foreign persons. As a result, investors cannot “code” their systems to block investments in covered foreign persons. Any attempt to

do so would likely be overly broad (e.g., the system could flag any investments in Chinese AI companies, even if the companies' AI systems do not appear to fall within scope of the OIR). A case-by-case analysis is, therefore, required, which could significantly slow down investment activity and, given the realities of today's trading environment, may prompt some to simply ignore the problem.

Even assessing whether an investment falls within the scope of an exception can be difficult. For example, the OIR exempts from coverage the acquisition of publicly traded securities as long as the U.S. person does not obtain rights "beyond standard minority shareholder protections." In the preamble to the regulations, Treasury recognized that in certain jurisdictions, including China, shareholders that acquire certain shares above a designated level (say 1%) acquire certain rights, including "the right to put forward for a shareholder vote a proposal to nominate directors." This right is not negotiated but is conferred by default under the applicable law. Treasury has said that this right is not a standard minority shareholder protection, and so the acquisition of publicly traded securities in excess of the designated thresholds is not within the scope of the exception. As a result, Treasury seems to expect that before investing in publicly traded securities, investors must understand what rights they might get by default in the listing jurisdiction, the jurisdiction of incorporation, the target company's bylaws or articles of incorporation, and so on. The feasibility of doing that in every case, particularly in a fast-moving trading environment, can be challenging.

At a minimum, investors that might be covered by the OIR should put in place written compliance programs and training to ensure that those making the investments decisions are aware of the relevant obligations. The policies, training modules, and diligence exercises can be standardized to a degree. Doing so could be a mitigating factor in any enforcement action, although it is not a replacement for closer examination of certain investments on an ongoing basis.

### **The Burden Sits With the U.S. Investor**

For jurisdictional and due process purposes, the OIR imposes obligations on U.S. persons, not the Chinese-affiliated target entities in which, for example, the U.S. person or its controlled foreign entity is investing. This means that the target entities may have little incentive to be fully forthcoming during the diligence process. As a result, the relevant U.S. persons must take particular care to collect whatever information they can from public or other sources to confirm the information that target entity might provide about its operations. The market is moving toward standard diligence questionnaires that ask targets to indicate whether they engage in covered activities, but in practice those questionnaires should be viewed as the starting point, not the ending point.

### **Tug of War Among Market Players**

A U.S. person's investment as a limited partner in non-U.S. funds is covered by the OIR if the U.S. limited partner "knows at the time of the acquisition [that the non-U.S. fund] likely will invest in a person of a country of concern that is in the semiconductors and microelectronics, quantum information technologies, or artificial intelligence sectors, and such fund undertakes a transaction that would be a covered transaction if undertaken by a U.S. person." However, certain exceptions apply, including in situations where the limited partner "has secured a binding contractual assurance that its capital in the fund will not be used to engage in a transaction that would be a prohibited transaction or notifiable transaction, as applicable, if engaged in by a U.S. person."

While this “segregation of capital” rule seems clear enough on its face, there is an ongoing tug of war over how such segregation should be accomplished, the extent to which a fund is willing to take on the obligation of conducting the necessary diligence and ensuring that the segregation is done properly, and whether the segregation must be made definitively at the outset with no ability to opt in to an investment in the future.

A similar tug of war exists with respect to lending transactions. For example, foreclosure on a loan may be a covered transaction, so lenders often require representations of whether the borrower is or may become, or may invest in, a covered foreign person or even whether the borrower engages in covered activities. Borrowers often push back on these demands as being overly broad.

The key takeaway on this point is that the market has not yet settled on a standard approach to contractual representations. No doubt this will be sorted out over time.

## **Enforcement**

Treasury issued enforcement guidelines in January and has already begun to reach out to certain investors and seek details of particular transactions. Some of these investigations are public, although the outcomes have not yet been disclosed. In some cases, there are clear, public disagreements about whether the OIR is applicable to a particular investment, with investors protesting that “X number of law firms have looked at this and told us the investment was not within scope.” Whatever the law firms may conclude, the ultimate decision will rest with Treasury. Perhaps through this process, Treasury will clarify aspects of the OIR that remain difficult to understand and implement.

## **Conclusion**

We expect that the OIR will continue to evolve through practice and further elaboration and clarification from Treasury. In January, Treasury issued a set of helpful FAQs, but since that time, it has issued only one set of three additional FAQs on important but narrow issues (investments in American Depositary Receipts and bank transfers in support of a covered transaction undertaken by a third party). We expect that Treasury will issue additional FAQs, but it would be helpful if the FAQs were issued more frequently.

Also, as Sidley explained in an earlier [Update](#), on February 21 President Donald Trump issued his America First Investment Policy Memorandum. This memorandum indicated that more changes with respect to the regulation of outbound investment are coming (more sectors, fewer exceptions) even before the market has fully adjusted to the January OIR. We expect that this will continue to be an active area, and investment funds and other investors should be vigilant to ensure compliance.

Sidley attorneys are closely monitoring changes in U.S. investment policy and are available to answer your questions.

## **CONTACTS**

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

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