Statement of the Honorable Thomas P. Feddo
Before the
National Security, Illicit Finance, and International Financial Institutions Subcommittee
U.S. House of Representatives Committee on Financial Services
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Chairman Luetkemeyer, Ranking Member Beatty, and distinguished Members of the Subcommittee, almost exactly a year ago I participated in the Financial Services Committee's first substantive full Committee hearing of the 118th Congress—which focused on combatting the economic threat from China. I am honored to appear before you today to continue particular aspects of that very important discussion—that is, the extent to which existing tools and authorities such as economic sanctions or export controls can effectively be leveraged to protect U.S. national security interests and mitigate risks posed by certain U.S. private sector investments in the People's Republic of China (PRC); and, at the same time, avoid increasing government bureaucracy or placing additional new burdens and controls on a strong, open, free-market investment environment.

My following testimony will explain why I am convinced that an economic sanctions program administered by the Treasury Department's Office of Foreign Assets Control (OFAC) would be the most immediate, efficient, and impactful way to address these risks.

As you may recall, I previously served as the Treasury Department's first-ever Assistant Secretary for Investment Security, where on behalf of the Treasury Secretary I led the operations of the Committee on Foreign Investment in the United States (CFIUS), including the implementation of its historic overhaul after enactment of the overwhelmingly bipartisan Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). I also bring to this discussion my experience during seven years at OFAC in senior leadership positions responsible for the civil enforcement of U.S. economic sanctions.

As I have emphasized in prior congressional testimony, the dangers posed by the PRC are real and present, not over-the-horizon. It is imperative to protect the United States and its allies from the PRC's strategy to exploit technology, raw materials, market power, and energy resources to achieve its ends. Supply chain resilience and integrity—especially in areas like semiconductors, energy resources, and critical minerals—are also vital to maintaining American security.

And, in the midst of an accelerating tech/industrial revolution, the United States must ensure that our military remains the most lethal in the world—maintaining or expanding its technology advantage in every possible respect, which translates to an advantage in every battlefield domain, whether maritime, air, land, cyber, or space.

The goal of maintaining tech superiority necessitates, among other things, reinvigorating the defense industrial base, fostering research and development, and building strong partnerships with the private sector—including innovation and venture capital ecosystems like Silicon Valley. It also means the careful and calibrated deployment of our economic might and related authorities, such as economic sanctions, export controls, and CFIUS, among others—what today is frequently referred to as "economic statecraft."

In recent years some policymakers and thought leaders have urged the government to screen and regulate outbound capital flows into foreign entities through the creation of yet another

regulatory authority. The idea has sometimes been described as an "outbound CFIUS" that would regulate what its proponents have described as "smart" money.

The scope of the ostensible national security gap motivating this push has not been precisely defined, but is generally described as arising from U.S. person venture capital and private equity investment into Chinese startups working in high-tech fields that could impact U.S. national security—like semiconductors, quantum computing, and artificial intelligence. A wide variety of other technologies have also been suggested.

And, because money is fungible and investors from Europe, other parts of Asia, or the Chinese government itself could reasonably be expected to replace absent U.S. capital, the concern relates to what U.S. investors might provide to these Chinese companies *in addition to* their investments—that is, the "smart," or intangibles, that accompany some non-passive investments, such as U.S. investors' management experience, institutional knowledge in the field, industry relationships and networks, etc.

It is my understanding that the data regarding the extent and type of U.S. venture capital flowing into Chinese companies is thin. It therefore follows that we lack clarity regarding both the proportion of that capital that could be considered "smart," and the proportion of those "smart" investments that might relate to critical technologies of concern or to companies affiliated with the PRC's civil-military fusion strategy.

Drawing from my extensive government service, including my time overseeing CFIUS and the implementation of FIRRMA, and given my belief in limited government, I remain skeptical of the effectiveness of a new CFIUS-like regime to screen where and how Americans invest their capital. It would be regulation- and resource-intensive, slow and bureaucratic—requiring substantial energy and effort to build an effective, clear, and precise regulatory framework, and to hire the necessary human capital. And because such transaction screening would be done in secret, there would be limited transparency and accountability, and real potential for arbitrary determinations or industrial policy-motivated decisions.

My prior testimony also explained my view that creating an outbound investment regime by Executive Order would be a significant misstep; that instead, Congress should lead on an issue of this complexity and potential impact, fully assessing the national security gap and then legislating a policy approach.

Despite the vague nature and extent of this asserted national security gap, President Biden last August issued Executive Order 14105, which directed the establishment of a new regulatory regime in an attempt to prevent "certain intangible benefits that often accompany United States investments and that help companies succeed, such as enhanced standing and prominence, managerial assistance, investment and talent networks, market access, and enhanced access to additional financing." The Treasury Secretary was directed to lead this Executive Branch effort, which to date has included the publication of an advanced notice of proposed rulemaking (ANPRM), plus a notice and comment period. A draft rule, further notice and comment, and a final rule are anticipated throughout the course of this year.

Executive Order 14105 is not a "screening" mechanism, but rather will impose either investment prohibitions or transaction notification requirements for U.S. person investment in certain technology sectors—semiconductors, quantum computing, and artificial intelligence. Congress

is also considering legislative proposals to expand the aperture of Executive Order 14105 to a variety of other high-tech sectors. Yet while not a committee-like screening regime, the Administration approach (and other "sector"-related proposals) will nonetheless require a new bureaucracy, new resources, new processes, and new regulations—which will create yet another unique set of compliance requirements and costs.

The limitations and risks of this sector-based prohibition and reporting regime should be apparent; and they are already demonstrated through the recent comments and feedback submitted by various stakeholders in response to the ANPRM that Treasury issued late last summer regarding Executive Order 14105. The ANPRM was largely an information-gathering exercise, setting forth 83 questions for the public, seeking guidance on issues ranging from the scope of the most fundamental definitions to the minutiae of specific technology. More than 60 substantive comments were submitted in response to the proposed regime.

The concerns articulated by ANPRM commenters, international trade experts, and experienced lawyers over the past several months include, among others:

- the scope and impact of the proposed broad definition of "U.S. person," and how foreign affiliates of U.S. funds, or U.S. affiliates of foreign funds, might be impacted;
- the vague and broad nature of a "knowingly directed" standard for determining whether a party has violated the regulations;
- the potentially vague scope of investor conduct that will or will not be permissible;
- the unclear and sliding-scale nature of the level of diligence regarding Chinese entities that will be required of investors (i.e., "reasonable and appropriate"), and the logistical challenge of actually conducting that diligence in China;
- the potential complexity and breadth of carve-outs from the prohibitions and notification requirements;
- the potential breadth and vagueness of the proposed definition of a "person of a country of concern" (part of which includes persons "acting for or on behalf of governments of a country of concern"); and,
- the considerable compliance and scoping risk potentially created by vague definitions of various technologies. A few examples include:
    - the difficulty in defining with meaningful certainty the relevant scope of AI (the ANPRM broadly suggests any "machine-based system that can . . . generate outputs . . . influencing real or virtual environments"); further, the ANPRM proposes regulating systems that are "primarily" or "exclusively" used for Chinese military or intelligence or mass-surveillance purposes (despite a potentially Herculean task for a U.S. investor to diligence this "primarily or exclusively" threshold);
    - the ANPRM suggests regulation of quantum computing "components," a broad term that could reach well beyond any emerging technology and instead regulate ordinary items and basic materials; and,
    - the risk of establishing essentially parallel but distinct sets of controls for advanced semiconductors—one for Executive Order 14105, and one under the Export Administration Regulations—that fail to align with one another, resulting in confusion and increased compliance costs.

Given the forgoing context, it is my belief that creating a new outbound investment authority, whether a screening mechanism or a sector-like regime, is a mistake. Since the start of the policy debate regarding the regulation of outbound investment, it has been my strongly held view that existing authorities provide the best means to address the asserted gap.

Specifically, I am convinced that the most immediate, efficient, and impactful way to address this risk is through the use of economic sanctions that would be authorized and scoped by dedicated legislation.

It is my understanding that, fundamentally, the goal is to restrict *U.S. persons* from providing not just investment capital, but from engaging in various services and other activities that might accompany certain investments into certain entities. In the national security context, the proven and time-tested way that the United States prevents U.S. dollar funds and U.S. services from being delivered or provided to someone, or somewhere, outside the United States, is through economic sanctions programs administered by OFAC.

These programs can be so effective because U.S. economic sanctions are inherently strongest when U.S. jurisdiction is at its apex—that is, when they are targeting or modifying the conduct or activities of U.S. persons. Economic sanctions targets are in certain respects punished, deterred, or impeded by the imposition of the sanctions, but this tool of economic statecraft ultimately has impact because it deters or prevents certain types of U.S. person conduct or restricts the operations of the U.S. financial system.

An economic sanctions approach would provide multiple benefits in the outbound investment context, including:

- OFAC is a sophisticated government agency with many years of experience implementing, administering, and enforcing multiple economic sanctions programs, and could therefore nimbly apply this experience and institutional knowledge to an outbound investment sanctions regime;
- economic sanctions program implementation processes and procedures, interagency coordinating structures, foundational regulations and definitions, and national security related infrastructure already exist at OFAC, the State Department, and the National Security Council;
- the U.S. private sector, including businesses and financial institutions of all sizes and levels of sophistication, is intimately familiar with economic sanctions requirements and already has compliance infrastructure and processes in place;
- it would impose a strict liability regime for regulatory violations (not requiring proof of intent), with civil monetary penalty exposure of twice the value of the transaction—thus creating an immediate and substantial deterrent effect;
- it would incentivize U.S. persons to divest prior investments into sanctioned entities;
- use of the U.S. financial system and the U.S. dollar as it relates to sanctioned entities would be prohibited, raising the risks for, and impeding the ability of, foreign persons to do similar business with the sanctioned entities;
- critically, the prohibition in services and dealings would also apply to the ecosystem of U.S. consultants and advisors who routinely provide—through contracts for services—many of the same "intangibles" described above (thus, the prohibitions would not single out just U.S. investors but other parties providing similar benefits);

- it would also have a licensing regime to authorize what would otherwise be prohibited—giving the government the flexibility and latitude to permit transactions that are in the foreign policy interest of the United States.

Congress could consider multiple strategies to frame such economic sanctions prohibitions, including:

- prohibiting investment in, the provision of certain types of services to, and certain trade-related transactions with, specified entities;
- as a "blocking sanction," designating the entity of concern on OFAC's List of Specially Designated Nationals and Blocked Persons (SDN List). In addition to the benefits outlined above, blocking sanctions would offer the additional advantages of: 1) blocking (or freezing) any property of the designated entity that comes within U.S. jurisdiction; and 2) the subsidiaries of, and many joint ventures involving, designated entities would automatically be blocked by virtue of the "50 percent rule." Thus, an SDN Listing largely prevents *any* dealing with the designated entity. This SDN approach has been adopted in the bill currently being considered by the Financial Services Committee, which leverages existing sanctions-related lists including the Chinese Military and Industrial Complex List, the National Defense Authorization Act's "1260H List," and the Commerce Department's Entity List and Military End User List;
- prohibiting investment in, and the provision of certain types of services to, companies located in a country of concern that are involved in developing a technology that would be export controlled if such companies were located in the United States;
- or, probably most effectively, some combination of the foregoing approaches.

The theft or misappropriation of American technology by the PRC and other bad actors must and can be prevented through appropriate resourcing and robust application of existing authorities—including economic sanctions, export controls, CFIUS, "Team Telecom," the Information and Communications Technology and Services regulations, the Defense Department's "foreign ownership, control, and influence" authorities, and criminal law enforcement.

Similarly, through the tailored use of economic sanctions and export controls in the context of outbound investment, U.S. persons can be prevented from providing services and support to Chinese entities that are part of that country's strategy of civil-military fusion.

A new bureaucracy with new authorities of potentially immense or poorly defined scope is not the answer, and in fact will introduce other challenges and complications.

The United States can enhance national security without creating unnecessary compliance burdens on and costs to U.S. persons' business transactions and global capital flows.

Again, it is my privilege to appear before you today and to contribute to your scrutiny of these issues consequential both to national security and the U.S. economy. I would be happy to answer any questions that you may have today, and to be a future resource for the Committee.

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