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The CFIUS Oversight Web Expands to Monitor Fund Managers

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Private investment funds and fund managers are increasingly getting swept into the expanded jurisdiction of the Committee on Foreign Investment in the US, which now plays a prominent part in private fund transactions across the board.

Funds managed or operated outside the US need to manage CFIUS compliance regularly. This includes reviewing investment activities and target investments, and the extent they implicate CFIUS filing requirements or risk assessment issues.

US fund advisers though, do not get a pass, and likewise regularly face the question of how to take on non-US investors while managing CFIUS compliance.

Evolving Enforcement Posture

The framework for such evaluations has been in place since enactment of CFIUS update legislation final implementing rules in 2020. What continues to change is the CFIUS enforcement posture—leading to more reviews of notified transactions and more investigations of transactions that were not subject to mandatory notification requirements.

A mandatory CFIUS filing is not triggered, where critical technology as defined in the rules is not implicated, or where a government investor is not acquiring a 25% interest in the broader technology, infrastructure, and data business category.

Under 31 C.F.R. § 800.248, a “TID U.S. Business” is a US business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; performs certain identified functions with respect to critical infrastructure; or maintains or collects sensitive personal data of US citizens.

Investment Fund Rules

Also key for investment firms is the specific clarification in the rules for investment funds—31 C.F.R. § 800.307—often relied on to manage foreign investments into US funds that invest in sensitive industries. Under that rule, an indirect investment by a foreign person in a TID U.S. business through an investment fund is not subject to CFIUS review where:

- The fund is managed exclusively by a general partner, a managing member, or an equivalent
- The general partner, managing member, or equivalent of the fund is not a foreign person
- The advisory board or committee that the foreign person investor sits on does not have the ability to approve, disapprove, or otherwise control investment decisions of the investment fund—or decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested
- The foreign person does not otherwise have the ability to control the investment fund
- The investment does not afford the foreign person substantive decision-making rights with respect to the use, development, acquisition, safekeeping, or release of sensitive personal data; the use, development, acquisition, or release of critical technologies; or; the management, operation, manufacture, or supply of covered investment critical infrastructure

Clarity on CFIUS Priorities

Adding new urgency, President Joe Biden issued a sweeping executive order on CFIUS enforcement and priorities, expanding the factors CFIUS considers when reviewing transactions for national security risks.

While the order didn't change CFIUS jurisdiction or filing requirements, it is a manifestation of the policy changes we have seen with respect to how foreign investment in the US is reviewed and scrutinized in this regulatory and political landscape.

The order identifies key factors in CFIUS review of national security risk, including the effect on resilience of critical US supply chains, the effect on US technological leadership, industry investment trends, cybersecurity risks that threaten to impair national security, and risks to US persons' sensitive data.

The Biden administration has said it would consider “geography, jurisdiction, [and] makeup of the investors” in “risk analysis.” And while China isn’t specifically identified in the order, it recognizes that “some countries use foreign investment to obtain access to sensitive data and technologies” in a manner that could undermine national security.

The sentiment among practitioners and investors is that the issues identified in the order skew towards Chinese investors, which means bringing Chinese domiciled investors into fund vehicles presents additional risk—even with respect to funds already under foreign control.

Importantly, the order also identifies aggregate industry investment trends as a factor for the Committee to consider when reviewing transactions—akin to the scrutiny of roll-ups we see with respect to enforcement under other regulatory regimes, namely antitrust.

The aggregate industry investment or roll-up concept aims directly at private equity and other types of investment firms with a sector or industry focus.

Government efforts to maintain US technological leadership also include proposals aimed at monitoring outbound investment—“reverse CFIUS.” The most recent versions of the reverse CFIUS (or outbound CFIUS) bills did not make it into legislation.

Thus, while reverse CFIUS is not yet law, continued bipartisan and executive support for such measures mean we can expect a form of reverse CFIUS requiring notification and review with respect to outbound investment that enhances capabilities with respect to a “national critical capability” in China and certain other countries.

These capabilities would implicate industries relating to semiconductors, large-capacity batteries, pharmaceuticals, artificial intelligence, and quantum computing. Recent reports to lawmakers continue to discuss a new regulatory system that would address investment in certain advanced technologies abroad.

Key takeaways are that CFIUS enforcement continues the upswing trajectory and should remain on the short list of regulatory and compliance items to address early and proactively for non-US managed investment funds, and for every transaction that may involve non-US funding.

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