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Research Report

Passive financing in the crosshairs: CFIUS intensifies focus on limited partners in covered private equity transactions

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Passive financing in the crosshairs: CFIUS intensifies focus on limited partners in covered private equity transactions

by

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Under the [Foreign Investment Risk Review Modernization Act of 2018](#), the Committee on Foreign Investment in the United States (CFIUS) codified its longstanding practice of focusing its national security reviews on the general partners of investment funds, rather than the limited partners providing capital. For US-based private equity funds, the Act curtails jurisdiction for CFIUS to review non-US limited partners, so long as they are passive (e.g., not given special information or access rights). Investments in US businesses by non-US funds are subject to review by CFIUS, but historically those reviews also focused on the controlling general partner, such that well-known non-US funds from allied jurisdictions largely escaped rigorous screening of their limited partners. Notwithstanding the Act codifying this historical focus on general partners, over the past year or so, CFIUS increasingly has been requesting additional information about limited partners in both non-US and US funds (US funds could trigger CFIUS jurisdiction, for example, with foreign coinvestment).

In May 2023, CFIUS explicitly evinced an intent to scrutinize limited partners when it published a [Frequently Asked Questions](#) (FAQs) addressing information requirements for foreign limited partners in investment funds. The FAQs response states that CFIUS “may request follow-up information with respect to all foreign investors that are involved, directly or indirectly, in a transaction, including limited partners in an investment fund.”

The FAQs did not create any new authority for CFIUS; CFIUS traditionally found authority to ask any questions during a review that could be relevant to evaluating threats to US national security,

including questions about limited partners' identity and governance. However, the response put private equity funds on notice to expect increasingly thorough and detailed information demands during a CFIUS review. Historically, even during more rigorous reviews, CFIUS did not require specific information on most foreign limited partners holding less than a five percent indirect interest in a US business. Private equity sponsors now must increasingly be prepared to field intrusive requests from CFIUS regarding the composition of their funds, even with respect to limited partners participating at *de minimis* levels. CFIUS is not alone in moving toward increasing disclosure. The Defense Counterintelligence and Security Agency, for example, routinely requires disclosure of all passive limited partners, disregarding the five percent threshold specified in [the agency's rules](#).

The FAQs also put private equity funds on notice that CFIUS expects such information to be provided “regardless of any arrangements that may otherwise limit the disclosure of such foreign person’s identity”—in other words, CFIUS recognizes that most fund sponsors have confidentiality restrictions in their agreements with limited partners and views this challenge to investor relationships as squarely falling to the fund sponsor to manage. Although CFIUS has a statutory obligation to maintain the confidentiality of any information received during its review, limited partners often object to funds in which they are invested revealing their investment position to CFIUS. In fact, passive limited partners investing at levels that represent five percent or less of a US business sometimes withdraw their investment in the face of CFIUS-mandated disclosure, leaving fund sponsors scrambling to replace their capital commitment. In the current investment environment, CFIUS applying outsized disclosure requirements to passive investors risks undercutting the value of passive investment for limited partners and general partners alike.

CFIUS historically has focused on general partners because the national security risk attributable to fund investments is driven by the general partners directing and controlling the partnerships. While CFIUS’s concern that non-US economic owners potentially could exert control or influence over a sensitive US business is understandable in unique situations, too much focus on passive, minority investments across the board undercuts a risk-based approach to reviewing transactions and is likely to have unintended consequences for US businesses, non-US investors, and CFIUS:

- CFIUS runs the risk of unnecessarily expending considerable time and energy probing these investments, diverting attention away from higher risk transactions, while hampering foreign investment and hindering US businesses’ access to lower-risk capital.
- An increasingly onerous review process driven by an outsized focus on passive investment skews the cost-benefit analysis for voluntary CFIUS filings, which comprise the preponderance of filings that CFIUS has the opportunity to review.

To counterbalance the need to protect US national security without unduly impairing the ability of funds to attract limited partnerships as a means of accessing capital, CFIUS and other national

security regulators should recognize the limitations already inherent in private equity structuring and governance and clarify their intent to continue focusing their reviews on general partners, absent specific circumstances that require enhanced scrutiny of limited partners. The Committee then can devote appropriate resources to the more limited universe of non-US limited partners that represent a material percentage of a fund, have negotiated special rights that raise national security concerns or are from jurisdictions that are particularly sensitive from a US national security perspective. This approach would better serve US national security interests, while also streamlining the review of transactions initiated by funds from jurisdictions aligned with US national security and foreign policy interests and mitigating the chilling effect on passive foreign investment.

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