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## Bank Failures May Raise CFIUS Issues

Companies need to be aware of filing requirements before taking foreign money

On March 14, 2023, after a week of three bank failures that marked the largest such crisis since 2008, policymakers continued seeking private buyers and working to stem any contagion by backstopping deposits. While the FDIC is currently ensuring the availability of deposits beyond the \$250,000 insurance limit for banks in receivership, companies could nevertheless encounter difficulties, particularly if more banks collapse or if there are other restrictions on liquidity. Companies that turn to foreign investors or lenders for needed funding for ongoing operations or debt must determine beforehand whether they trigger a mandatory filing with the Committee on Foreign Investment in the United States (“CFIUS”).

### BACKGROUND

CFIUS is an interagency committee authorized to review certain transactions involving foreign investments in U.S. businesses to determine their effect on the national security of the United States. CFIUS can mitigate any national security risk resulting from such a transaction, or even recommend to the President of the United States that the transaction be prohibited. While most transactions involving foreign investment fall within the voluntary filing category, a small but important subset of foreign investments **require** that a filing be made with CFIUS at least 30 days **before** closing the transaction.

### CFIUS FILING REQUIREMENTS

A CFIUS filing is mandatory if an investment provides a foreign person with “control” over certain types of U.S. businesses that produce, design, test, manufacture, fabricate, or develop critical technology where an export authorization would be required. CFIUS control broadly refers to the power through majority or dominant minority ownership of the total outstanding voting interest, board representation, proxy voting, special shares, contractual agreements, arrangements to act in concert, or other means, to



determine, direct, or decide certain important matters affecting an entity. Such power is considered “control” whether it is direct or indirect, exercised or exercisable, individual or aggregated.

For some U.S. businesses that perform certain functions with respect to critical technology or critical infrastructure, or that maintain or collect—directly or indirectly—identifiable sensitive personal data of U.S. citizens (*i.e.*, “TID businesses”), a foreign investment may trigger a mandatory filing. A CFIUS filing may be required even where there is no control, but the foreign person is afforded access to material non-public technical information, board rights, or involvement in substantive decision-making, and where the investor holds at least a 25% stake in the U.S. TID business and is at least 49% owned by a foreign government. Even if a filing is not mandatory, however, CFIUS can request a filing from the parties and unilaterally initiate a review should they refuse.

### CFIUS IMPLICATIONS IN BANK RECEIVERSHIP

**Foreign Investment in Banks.** Depending on the types and volume of services performed and U.S. citizen data held, financial institutions may be considered U.S. TID businesses. Thus, if a foreign-owned entity acquired 25% or greater of that institution, as well as access, board, or decision-making rights, the parties could be required to file with CFIUS. Such a mandatory CFIUS filing would have to be made at least 30 days before closing the transaction.

**Foreign Investment in Bank Customers.** Bank customers may be required to submit a CFIUS filing before accepting foreign money if the companies are U.S. TID businesses. Thus, if such a company is seeking to raise foreign capital to cover its operations or debts until it can recover funds from the FDIC receivership or new owner, it may need to file with CFIUS before closing that transaction. Alternatively, the parties would need to agree that the foreign investor will forego the important rights that establish CFIUS jurisdiction.

**Foreign Loans to Bank Customers.** CFIUS regulations generally carve out traditional lending transactions, even where the foreign person has a secured interest over securities or other assets of the U.S. business. However, if a loan or a similar financing arrangement enables a foreign person to acquire an interest in profits of the U.S. business, the right to appoint board members, or other comparable financial, access, or governance rights characteristic of an equity investment, the transaction is reviewable by CFIUS. Moreover, if the recipient is a U.S. TID business, the transaction could trigger a mandatory filing. CFIUS may also have jurisdiction over lending transactions in circumstances of imminent or actual default or other conditions with the significant possibility that a foreign lender may, as a result of the default or other condition, acquire the requisite control or other important rights.

Like lending transactions, convertible debt instruments generally are not covered transactions, unless a foreign holder has control over certain elements (e.g., when the instrument is converted) or obtains equity-like rights upon conversion. When determining whether such an instrument may be a covered transaction, CFIUS considers:

- the imminence of conversion or satisfaction of contingent conditions;
- whether the acquiror controls the conversion or satisfaction of contingent conditions; and
- whether the amount of interest and the rights acquired upon conversion or satisfaction of contingent conditions can be reasonably determined at the time of acquisition.

Otherwise, a contingent equity interest is not subject to CFIUS jurisdiction until conversion.

### KEY TAKEAWAYS

The customer bases of the recently failed banks were heavily populated by U.S. venture-backed startups and companies operating in the technology, life sciences, and cryptocurrency sectors. Customers operating in these areas are more likely to be U.S. TID businesses under CFIUS regulations. Thus, there also is a higher likelihood



that a mandatory filing would be required if they took foreign investments or made equity-like loans or financing arrangements with foreign persons.

Failure to make a mandatory CFIUS filing within the required period can result in civil monetary penalties up to the full value of the transaction. In October 2022, Treasury published the first-ever CFIUS Enforcement and Penalty Guidelines, which provide more transparency into the enforcement process and help the public understand the Committee's priorities and considerations in ensuring compliance with CFIUS statutes and regulations, including filing requirements. The Guidelines also signaled that new leadership intends to drastically ramp up enforcement actions this year.

CFIUS has also increased its focus on TID businesses, including those in the technology, life sciences, and payments sectors. In September 2022, the White House issued an Executive Order ("EO") giving guidance to CFIUS regarding its national security priorities. This EO—which was the first issued since CFIUS was created in 1975—reaffirmed that technology and life sciences companies were top national security priorities. CFIUS has also devoted more resources to expanding its non-notified team to pursue those transactions that have not been filed with the Committee, but which CFIUS believes present potential national security risks. A significant portion of non-notified transactions brought in for review—and mitigated or prohibited—have been in these critical sectors.

### LOOKING AHEAD

CFIUS has the necessary authority, resources, and motivation to find, pursue, and penalize companies who do not file with the Committee when they should. Given the Committee's heavy focus on technology, life sciences, and payment systems, investors and corporate entities operating in these sectors should expect extraordinary scrutiny. Although the funding need may be urgent, recipients of foreign money must determine whether a CFIUS filing is required before closing the transaction to avoid possible penalties. Even if a CFIUS filing is not mandatory, transactions reviewed through the non-notified process are more likely to result in required mitigation measures or ordered divestment. Having these measures imposed long after closing (there is no statute of limitations on CFIUS jurisdiction) can be extremely disruptive to the operational and financial aspects of the companies involved.

Companies seeking foreign investments, loans, or similar financing arrangements may benefit from working with experienced counsel to determine whether a CFIUS filing would be required, advisable even if not required, or perhaps made unnecessary through the drafting of the transaction terms. King & Spalding has a global footprint, substantial industry experience, and a deep bench of former trade and national security government officials, including a former U.S. Department of Treasury official who recently helped lead the office that chairs CFIUS, and is uniquely positioned to guide companies through such an analysis.



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