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Baring/Virtusa: IT Services Deal May Stoke CFIUS Fears About Corporate Networks, Consumer Data

Baring Private Equity Asia's proposed $2 billion buyout of Virtusa (VRTU), a Massachusetts IT services provider, may draw close scrutiny from U.S. national security officials concerned about giving the Hong Kong-based acquirer deep access to American corporate networks and consumer data, legal experts said.

Virtusa builds and maintains information-technology systems for Fortune 500 companies active in industries ranging from banking and healthcare to manufacturing. Its acquisition by Baring, which controls more than 40 companies in Asia, would raise obvious red flags at the Committee on Foreign Investment in the United States (CFIUS), the experts said.

The interagency panel, which screens deals for national security threats, has increasingly focused on preventing the Chinese government from collecting personal information on U.S. residents and sabotaging American businesses.

In past reviews, CFIUS has generally treated Hong Kong acquirers as if they were from the mainland. That practice increased after Chinese President Xi Jinping cracked down on political freedoms in the financial center earlier this year, the experts said.

Despite these potential red flags, Baring may be able to soften the panel's apprehensions by noting that 24% of Virtusa will be owned by a prominent pension fund in Canada, a close U.S. ally. The Asian private-equity firm can also point to recent national security approvals for its takeover of medical-equipment maker Lumenis and another software-related transaction as indicating that it's not a security risk.

Nonetheless, deals such as this may raise a complex set of issues, said Harry Broadman, a former U.S. assistant trade representative who served on the panel during the administrations of President George H.W. Bush and Bill Clinton.

"It looks like there are quite a number of factors to be considered" by CFIUS, he said.

The committee will need to evaluate the risk to American personal data and intellectual property amid rising misgivings about investments related to China, said Broadman, who now chairs the Emerging Markets Practice at Berkeley Research Group LLC, a global consulting firm covering investment, trade and antitrust dispute litigation.

One wild card in the review is the upcoming U.S. presidential election, he said: “Political uncertainty is a huge factor.”

With the vote less than 30 days away, President Donald Trump has sought to boost his sagging poll numbers by ramping up his rhetoric and actions against China, forcing a partial divestiture of social-media site TikTok and attempting to ban the WeChat communications app in the U.S.

CFIUS suspicions about Hong Kong companies are unlikely to ease anytime soon—even if Democratic challenger Joe Biden defeats Trump—because the concern about China and Hong Kong is bipartisan, Broadman said. But a Biden administration would probably be more thoughtful about panel reviews and seek to sound out allied leaders before deciding on deals, he said.

Spokespeople for Baring, Virtusa and CFIUS didn’t respond to requests for comment.

Baring’s track record. Despite its ties to China, Baring has had some success with CFIUS. The committee recently approved Baring’s $1.2 billion acquisition of Lumenis, an Israeli producer of laser equipment for hair removal, cellulite reduction and other cosmetic procedures. Lumenis owns subsidiaries in the U.S., which gave CFIUS authority to review the transaction.

Baring also received CFIUS approval within the past 12 months in connection with a software-related transaction, Virtusa said in a September regulatory filing, giving no further details about the deal in question.

However, Baring in late 2019 agreed to pay $1 billion to acquire an 80% stake in CitiusTech, a New Jersey-based provider of healthcare technology and business services. That deal required CFIUS notification and approval.

In a move that may ease some CFIUS concerns, the Canada Pension Plan Investment Board announced last month that it had agreed with Baring to invest $300 million in Virtusa in exchange for 24% stake in the company. CPP Investments, a pension fund covering millions of Canadian retirees, called itself a “long-standing partner” of Baring.

Even so, the panel is sure to run a fine-tooth comb over Baring’s extensive ties to China. The buyout firm holds controlling stakes in China-based enterprises including World Freight Services and HCP Packaging. Baring owns minority interests in at least five other Chinese enterprises, and a full 14 of its 32 managing directors are based in Hong Kong, Beijing and Shanghai.

“CFIUS will surely investigate any dealings Baring Private Equity has with China, especially investments where Baring and the government of China are co-investors,” said one lawyer familiar with CFIUS, who represents private-equity firms based in Hong Kong and Beijing and requested anonymity for that reason.

What CFIUS will examine. Virtusa's significant workforce overseas—mostly in India and Sri Lanka—could prompt CFIUS to scrutinize its planned post-merger board and management structure, to ascertain how it would protect U.S. citizens' data and software.

CFIUS also will want to explore the depth of Virtusa's relationships with Microsoft and Amazon, which supply the U.S. federal government with cloud-computing services, security experts said. Amazon Web Services (AWS) provides cloud services to the Central Intelligence Agency, while Microsoft won the hotly contested Joint Enterprise Defense Infrastructure (JEDI) contract to supply cloud services to the Defense Department. Both companies are vying for the Commercial Cloud Enterprise contract, which aims to put data from 17 U.S. intelligence agencies in the cloud.

AWS and Microsoft both possess government security certifications—the Federal Risk and Authorization Management Program (FedRAMP) and the Defense Department's Cloud Computing Security Requirements Guide (SRG)—that restrict their ability to work with companies closely affiliated with China. Each company has at least three data centers with FedRAMP certification; they are authorized under SRG to store on their cloud servers the most highly classified intelligence and military information.

Virtusa describes itself as a Microsoft partner and a leading "solutions implementer" for its SharePoint cloud service. Virtusa has also managed data storage for Microsoft cloud provider Azure. At AWS, Virtusa says it is a "premier consulting partner," providing cloud management consulting and cloud migration solutions.

In addition, Virtusa works with Salesforce, Google Cloud, Adobe, Talend and SAP on cloud projects, data storage and a range of management services, including data migration and data analytics. Virtusa also supplies corporate customers with cybersecurity services; digital-process automation, which uses software to optimize workflows; and intelligent automation services, which rely on deep machine learning as well as face, voice and speech recognition.

CFIUS will also examine how much access Virtusa has to export-controlled technology and customer information, the experts said. The panel can likewise be expected to review the company's role in supplying technology that facilitates banking and insurance services, the experts said.

Virtusa provides blockchain products to help financial institutions track cross-border payments; digital-payment products to facilitate electronic billing; and smart portals to support supply-chain and financial management at insurers, banks and other businesses.

Virtusa has delivered cloud-management services to "North America's largest life insurance provider," according to the company's website, which doesn't identify the client. Prudential Life was the largest life insurer ranked by assets in 2019, followed by MetLife and New York Life, according to credit agency AM Best.

To mitigate against concerns on this front, the committee would probably seek guarantees that the personal data of Americans would be stored on servers in the U.S. The panel might also appoint an independent monitor to oversee the use of sensitive data and technology, the experts said.

Political calculus. Baring will have to navigate a CFIUS process that has grown more politically charged in recent years, the experts said.

The private-equity firm unveiled the deal in September, when the Trump administration was taking some of its most public action yet to rein in China's access to U.S. technology and data. In August, Trump issued one executive order compelling Chinese tech giant ByteDance to divest part of TikTok and another order banning Tencent's WeChat app.

Baring's takeover of Virtusa could raise thorny political questions for the Trump administration, which has pledged to help American workers by curbing immigration and bringing jobs back to the U.S. Those difficulties go beyond the buyer's base in Hong Kong.

Virtusa has more than 22,000 employees worldwide, the "vast majority" of whom are in India and Sri Lanka, according to the company's latest 10-K. Virtusa is also classified as "H-1B-dependent" business, meaning that at least 15 percent of its employees in the U.S. hold H-1B visas reserved for highly skilled foreign workers.

A CFIUS review of the deal could extend well beyond the end of the president's term on January 20, potentially leaving the decision to Biden, who has vowed to ease Trump's limitations on immigration, including restrictions on H-1B visas.

But the Trump administration might well hesitate to approve a deal that would aid a business so dependent on foreign employees, said an expert who requested anonymity due to the sensitive nature of the deal.

"The 'America First' policy could come into play here," the expert said. "Just like with TikTok, the Trump administration could make an example out of this deal."