



# Walk the Line: Security, Scrutiny, & Stewardship in Defense Investing

Malk Insights — Q3 2025

## Executive Summary

Rising geopolitical instability and increased government spending have increased interest in the defense sector [among private equity investors](#). At the same time, [heightened ethical scrutiny](#) around international conflicts, driven by societal pressure, limited partner (LP) expectations, and expanding international reporting requirements, demands that general partners (GPs) be responsible stewards of their capital. This piece applies a stewardship lens to defense investing, equipping investors with practical tools to navigate the fine line between national security imperatives and reputational or regulatory risk. By understanding key risk areas, leveraging established frameworks, and asking the right questions, investors can invest responsibly in defense without compromising fiduciary duties or public trust.

## The Line Between Scrutiny and Security

Defense capabilities are essential for safeguarding national security and managing geopolitical instability. For private equity investors, businesses providing essential services present attractive investment opportunities. Yet this landscape also introduces a unique challenge: *How can legitimate defense capabilities be enabled whilst navigating the scrutiny placed on those who participate in or contribute to the conflicts for which they are intended?* Investors can find themselves considering investments that operate legally under international and domestic law, but still carry risks, from the provision of targeting systems that inadvertently cause civilian harm to intelligence and surveillance services that raise concerns over civil liberties. Crucially, there is no single, comprehensive public benchmark that defines “best practice” for navigating these tensions. Standards vary by both jurisdiction and stakeholder, from regulators and LPs to the general media-consuming public, and they evolve rapidly as current events unfold. This makes robust internal frameworks and rigorous applications essential for GPs. Proactive stewardship helps ensure that risks are identified, governance measures are in place, and legitimate defense capabilities are supported without crossing lines that could expose investors to avoidable regulatory or reputational fallout.

## Key Stewardship Risks in Defense

For investors, it’s critical to pinpoint what is most likely to trigger heightened scrutiny – whether from regulators, LPs, or the public. By mapping sensitive areas in advance, investors can develop practical stewardship plans that balance defense operations with credible oversight. The following areas illustrate where robust governance, clear policies, and informed engagement are the most essential:

- **Controversial Weapons:** Definitions of controversial weapons vary but generally include weapons that cause indiscriminate harm, such as biological and chemical weapons, cluster munitions, and anti-personnel mines. Frameworks such as the EU SFDR explicitly flag these through [Principal Adverse Impact](#)

[Indicator #14](#). Though the [U.S. Munitions List \(USML\)](#) does not use the term, it does segment munitions into 21 categories helpful for evaluating the relative capabilities, risks, and therefore scrutiny. From an investor perspective, sensitivity stems from both regulatory requirements (e.g., national export controls) and LP mandates that restrict investment in related businesses through exclusion lists and side letters.

- **F2T2EA (Find, Fix, Track, Target, Engage, and Assess):** The chain of decisions and actions involved in destroying a target is a long one, best described by the military concept of “F2T2EA”, more colloquially referred to as the “kill chain.” Companies contribute at multiple points in this chain, supplying everything from satellite imagery and geospatial analytics to AI-powered targeting software, autonomous drones, and munitions. Naturally, lethal and/or destructive actions are those most likely to draw scrutiny from various stakeholders and observers. The more directly a company is involved in the deployment of these actions, the more likely it is that scrutiny for that action will implicate the company. For GPs, it’s crucial to understand a prospective investment’s position in the kill chain, whether their role is more or less integral to these high scrutiny actions, and how that role aligns with public and investor expectations. This visibility helps investors understand risks prior to investment due diligence and prepare to respond in the event of scrutiny directed towards portfolio companies.
- **Civilian Harm:** While defense companies are expected to operate within the bounds of [international humanitarian law \(IHL\)](#), distinguishing between legitimate military targets and civilian populations is inherently complex, and lapses still occur. These lapses, whether they are in judgment or execution, can result in civilian deaths and injuries, as well as damage to critical or sensitive civilian infrastructure (e.g., schools, hospitals, heritage sites). Beyond demanding that their prospective investments and portfolio companies comply with IHL, investors should also understand companies’ relative risk of inadvertently harming civilians – this tends to be higher, for example, among companies that produce munitions than those providing articles with less destructive potential. A perceived failure to prevent or respond to civilian harm can trigger significant legal, customer, and reputational backlash, making proactive oversight and robust diligence essential.
- **Civil Liberties:** In the age of technology, defense companies increasingly provide products and services for intelligence, surveillance, and reconnaissance (ISR) activities conducted by both the defense and intelligence communities. Examples include biometric tracking through advanced sensors, mass data collection, and AI analytics for identifying prospective targets. While these capabilities can strengthen defense and intelligence operations, they also raise significant civil liberty concerns, particularly when used for domestic surveillance or in jurisdictions with records of human rights abuses. Use cases such as monitoring political dissidents or conducting surveillance without due process can draw intense reputational scrutiny from civil society, the media, and regulators. Investors should assess whether portfolio companies have strong human rights policies and due diligence processes to mitigate misuse among the customers they sell to.

### What Frameworks Exist?

While there is no single preferred framework for investors seeking to navigate the unique challenges associated with defense investing, they don’t need to start from scratch. Several globally recognized frameworks can provide meaningful guidance for aligning oversight with international norms. While not written specifically for defense contractors, the [UN Guiding Principles on Business and Human Rights \(UNGPs\)](#), the [OECD Guidelines for Multinational Enterprises](#), and the [Universal Declaration of Human Rights \(UDHR\)](#) anchor best practices for managing human rights risks that often intersect with defense activities. These resources can help investors

understand what risks ought to be managed by defense contractors, such as those associated with civilian harm and civil liberties, as well as what practices a contractor should undertake to manage them well.

Export control regimes in the U.S. and E.U., such as the [International Traffic in Arms Regulations \(ITAR\)](#) and the [E.U. Dual-Use Regulation](#), set clear legal guardrails for how sensitive technologies and products can be transferred across borders. Understanding these regimes is valuable not just for managing strict compliance risk but also for evaluating the relative sensitivities and risks of different products, services, and technologies. Strong export compliance is essential, but investors should also monitor how their portfolio companies manage the permitted and prohibited end-use of what they sell, adapting as appropriate for changes in sanctions or geopolitical risk.

The [E.U. Sustainable Finance Disclosure Regulation \(SFDR\)](#) plays an increasingly influential role in how investors evaluate defense exposure, particularly for funds classified under Article 8 or 9. While SFDR does not prohibit investments in controversial weapons, [Principal Adverse Impact \(PAI\) indicator #14](#) requires disclosure on whether a company is involved in their production or sale. This disclosure doesn't impose a ban, but it flags the activity in a way that can shape how capital is allocated, especially for funds marketed as sustainable or ESG-aligned. A "Yes" response to this indicator can open the door to additional scrutiny from LPs and establish the expectation for strong stewardship practices, as described in this article.

### How PE Investors Can Respond

GPs can manage defense sector risks more effectively by embedding practical stewardship actions throughout the investment cycle:

- **Frame defensible stewardship strategies** that demonstrate proactive risk management and support transparency with LPs who may face their own reputational or compliance pressures.
- **Conduct targeted due diligence** to identify red flags, including exposure to controversial weapons, high-risk end users, and export control vulnerabilities, and assess how well governance and compliance systems are equipped to manage them.
- **Maintain active stewardship post-close** including board-level discussions on end-use, civilian harm mitigation, and human rights risks, along with transparent reporting that builds trust with LPs.

### Conclusion

The defense industry isn't going away – and neither is the scrutiny that participants are placed under. Stewardship offers PE investors a credible way to manage risk and demonstrate proactive oversight whilst enabling national security and seeking risk-adjusted returns. Now is the time for investors to take stock of where their firm stands, where it could be exposed, and how a clear, intentional approach can help avoid surprises to maintain trust with LPs and the broader public.

Malk Partners works with GPs to build defense-ready diligence and portfolio management processes. Malk helps investors assess exposure across their portfolios, align policies with relevant international frameworks, and uphold LP expectations for responsible stewardship. Malk can provide support as part of broader ESG services or through standalone stewardship engagements, giving GPs the structure and visibility needed to manage sensitive defense investments with confidence.

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