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From the Editors

After the private equity industry's tremendous rebound from the challenges brought on by the pandemic in 2020, the momentum continued through 2021. Low interest rates, massive amounts of dry powder and record fund-raising on both the primary and secondary markets fueled a torrent of investment activity.

As we begin 2022, the industry's biggest challenge—aside from intense competition for deals and increased valuation of targets—is on the regulatory and legal front. Sponsors face a more hostile antitrust environment, greater scrutiny over ESG disclosures and deeper probing into their agreements and operations for conflicts of interest and inappropriate incentives. Sponsors in disputes with host States arising from European Union cross-border investments are facing difficulties in accessing treaty protections, and investors in U.S. healthcare are finding themselves at risk for False Claim Act suits. All of these developments will require sponsors to focus on the execution of fundamentals, such as due diligence and compliance controls, while also ensuring that they provide fund investors with comprehensive disclosure that accurately reflects their practices and operations.

We hope that you find the *2021/2022 Private Equity Year-End Review and Outlook* to be a helpful guide to some of the key issues now on the private equity agenda.

"Mom's currently in a meeting—will she know what this is in reference to?"

CELEBRATING 20 YEARS THE PRIVATE EQUITY REPORT

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Private equity fundraising spent 2021 in an upward trajectory, reaching record levels by the end of the year. This torrent of incoming capital added to the already high level of dry powder sponsors are looking to deploy. Massive amounts of cash on hand and the continued availability of cheap debt has led to heated competition for assets, full deal pipelines and shortened deal timelines, even in the face of uncertainty brought by the extended pandemic and new COVID variants. The fast fundraising pace established in 2021 is likely to continue at least into the first months of 2022, as fundraising's underlying fundamentals remain in place. Activity may well increase even further, as sponsors rush to take advantage of the current low interest rate environment, which has resulted in cheap high-yield debt, in advance of the Fed's expected interest rate hikes.

The volume of fundraising activity has led to a crowded market and is fueling several continuing trends, as sponsors seek to deploy capital in nontraditional fund strategies, open-ended products and other hybrid structures to restructure their existing interests in assets through continuation funds (please refer to the Alternative Assets Transactions and Liquidity Solutions section below for further details) and to create other tailored fund products, including those aimed at making private equity investments attractive for insurance company investors.

Finally, private equity sponsors continued to turn to ESG-driven investment strategies in the latter half of 2021, focusing on environmental and diversity and inclusion initiatives. While this push is expected to continue into 2022, there are certain headwinds with which sponsors that are pursuing ESG investment strategies will need to contend. Regulatory uncertainty and a lack of broadly accepted financial metrics for ESG performance can create difficulty implementing and reporting compliance with ESG initiatives. This uncertainty may lead to more requests to general partners for information and transparency to confirm that the fund's ESG principles are being adequately implemented. In any event, a rising global tide of investor commitment to environmental, social and governance issues will likely drive further investor demand for corporate responsibility that sponsors cannot ignore.

Alternative Assets Transactions and Liquidity Solutions

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A torrid deal pace in the GP-led transactions market highlighted the continued high volume of activity in the secondaries market in 2021. In keeping with a trend that began in the second half of 2020, single-asset continuation vehicles in particular continued to represent a significant portion of deal activity.

Having completed several bumper fundraising cycles, secondaries buyers have accumulated war chests of dry powder while Covid-related market uncertainty seems to have dampened sellers' desire to bring attractive assets to market. The resulting intense competition for high-performing assets has led to a seller-friendly market, allowing sellers to command not only favorable pricing, but also address issues other than liquidity in many transactions.

Evolving Terms

In the GP-led market, we are seeing more and more crossover from buyout M&A techniques and technology. In particular, contemporaneous portfolio company-level refinancings or dividend recapitalizations, as well as recourse solutions such as representation and warranty insurance, have become increasingly common in single-asset continuation fund lift-out transactions. One factor driving this development is the growing tendency of sponsors to approach single-asset transactions in the same manner they would approach a typical third-party M&A exit (from the selling fund side) and a third-party acquisition (from the continuation fund side) and seek to achieve similar aims (*e.g.*, a nonrecourse transaction, from the selling fund side, or optimizing use of leverage, from the continuation fund side). In addition, other market participants, such as banks and insurers, are gaining greater familiarity with GP-led transactions and are developing products aimed at the GP-led market.

At the same time, on the continuation fund side of GP-led transactions, the seller/sponsor-friendly dynamics of 2021 have allowed sponsors to command favorable terms, such as advantageous carry structures, including "super-carry."

In "traditional" LP fund interest secondaries, this seller-friendly environment has also enabled creative sellers, particularly those bringing blue-chip portfolios to market, to achieve goals beyond liquidity. These sellers are exploring transaction structures that enable them to retain post-sale upside to the portfolio, requiring seller-directed transaction syndication and extracting stapled primary investment capital to be deployed at their direction. At the same time, sellers are increasingly, and often successfully, pushing long-settled purchase agreement terms in their favor.

Cross-Fund Transactions

While 2021 has continued to see sponsors utilize continuation vehicles to offer LPs liquidity and to crystallize economics, we have also seen a surge in transactions where sponsors have coupled a continuation fund with an investment by a successor flagship fund (*i.e.*, a cross-fund transaction). Such compound transactions enable sponsors to leverage the conflict-of-interest mitigation strategies already common

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Alternative Assets Transactions and Liquidity Solutions

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in continuation fund transactions to facilitate cross-fund transactions that might otherwise be viewed with skepticism by investors. From a secondary investor perspective, the alignment with the GP inherent in such compound transactions is seen as an overall positive. However, there is some unease about the ongoing conflicts of interest between the continuation vehicle and the successor fund that such a transaction structure may entail, and the possibility that the continuation vehicle may in reality function as a fee-paying or carry-paying co-investment vehicle alongside the successor fund, which is one possible endpoint of such a structure.

Competition for Allocation

The increased pace of transactions and the competition for sought-after, high-value assets has also led to increased competition for allocations. Investors have thus found themselves pressured to complete due diligence on investment opportunities at a faster pace and to rely more heavily on alignment with sponsors so that investor syndicates can move quickly, and individual investors can present as attractive partners. In this climate, buyers who have both primary and secondary capabilities are well positioned, able to leverage strong LP relationships with sponsors while bringing to bear their expertise and execution capabilities to secure allocations in competitive deals.

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In 2021, the fund finance market followed the trajectory set by the prior year, fueled by the combination of record-breaking fundraising and a low interest rate environment. The market has been further energized by the increased use of previously overlooked forms of financing—GP, NAV and hybrid facilities, as well as borrowing collateralized by management fees—which has both provided new sources of liquidity for cash-strapped funds and expanded the overall private equity toolkit.

Even though subscription credit facilities are the plain vanilla product in the fund financing space, the large number of such financings last year for single-managed accounts ("SMAs") and funds with nontraditional investors was notable. ESG mechanics in such facilities also remained a focus, driven by a consensus among lenders, borrowers and LPs to set financial incentives for social responsibility. With ESG investments expected to triple by 2040, we expect further growth and innovation in this area in the coming years.

Fund finance teams were also kept busy in 2021 by regulatory requirements to cease entering new USD LIBOR-based facilities and to replace the reference-rate mechanics for all GBP LIBOR facilities by the end of the year. This triggered a flurry of refinancing and amendments to sponsors' credit instruments. Given the lack of market consensus around the real-world implementation of SOFR, the replacement rate for USD LIBOR, many sponsors opted for flexible benchmark replacement provisions, allowing for a "wait and see" approach until standards develop. We expect market practice on this issue to crystallize during the first half of 2022.

In addition, the CLO market began to thaw out after a long winter caused in part by regulatory uncertainty, and new CFO issuances finally resumed late in 2020 after more than a year of no new activity for these products. This trend is likely to continue.

We expect fund financing to become even more important to our clients in 2022, as sponsors increasingly view fund-level credit as a key source of liquidity and yield. The growth in funds with direct lending strategies will further boost this development. The new year will also see continued innovation as existing and new entrants compete to provide bespoke products to meet the needs of private equity.

Leveraged Finance

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The close of 2021 marked the end of a record-breaking year for the finance markets. Buoyed by robust M&A activity, the return of the mega-buyout, continued growth of alternative capital providers and investor demand for CLOs, financing activity during 2021 eclipsed the record-breaking figures of 2020.

As tracked by the S&P/LSTA Leverage Loan Index, CLO investment finished the year at an all-time high, exceeding the prior full-year record by 45 percent, while leveraged loan issuance finished 22 percent above its previous best. The increase in CLO activity helped drive loan margins lower and allowed issuers to continue to seek borrower-friendly deals, pushing terms historically reserved for large-cap deals into middle-market transactions. We expect this trend to continue, driven by ongoing investor competition for deal allocations.

Throughout 2021, the competitive M&A market resulted in deals being executed at elevated leverage levels. To help finance these transactions, participants incorporated preferred equity issuances, investment-specific fund-level financings and holding company financings into their capital structures. Once reserved for the most bespoke transactions, these capital solutions are becoming de rigueur, as private equity sponsors seek a capital structure that will allow them to achieve attractive investment returns. The growing importance of these types of financings is reflected by the fact that both the syndicated and private capital markets are competing to provide them. While third-party sources are a ready source of such financings, many sponsors prefer to offer the opportunity to provide such financing to their limited partners, thus giving LPs a separate means to invest capital with the sponsor.

Another financing trend that we expect to continue in 2022 is the use of recurring revenue rather than traditional EBITDA metrics. Most common for issuers operating in the software industry, recurring revenue financings have long been the province of private credit funds, now the source of increasingly large financings (including several transactions approaching the $2 billion threshold). However, with the growth of CLO funds that include investment mandates allowing for the purchase of recurring revenue loans, we expect to see an increased number of syndicated recurring revenue financings brought to market.

Last year also saw ESG-linked financings move to the mainstream, in response to heightened demand from both issuers and investors for these products. In 2022, we expect market participants to more acutely focus on ESG-linked financings and to incentivize those issuers that incorporate ESG provisions into their financings such as margin ratchets linked to the achievement of ESG KPIs.

While 2021 was a record-setting year, as we look ahead to 2022, we expect the current trends to continue as investors seek attractive debt investments, and deal making activity maintains at fever pitch.

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The year 2021 will be remembered as a record-breaking year for M&A activity in no small part because of private equity. Private equity M&A activity reached an all-time high of $1.2 trillion last year, more than doubling 2020's levels. Healthy debt financing markets and piles of dry powder led to strong PE M&A activity on the buy side, while a myriad of alternatives were available to private equity firms looking to exit investments this year. SPACs provided one such path, with sponsors often running dual-track processes that pursued both a traditional sale and SPAC merger. Continuation funds were another notable exit option in 2021, particularly for investments in sectors of the economy still being affected by pandemic market uncertainty.

Not all of 2021's developments were positive, however. In particular, the change in attitude at the Federal Trade Commission ("FTC") casts a shadow over future dealmaking. Comments from the new Chair, Lina Khan, make it clear that the FTC will be looking at private equity deals—even those with no competitive overlap—with enhanced scrutiny. Indeed, second requests were more frequent and probing in 2021. The FTC also took to issuing new "warning letters" to remind parties that the FTC has the right to challenge transactions after closing, injecting new uncertainty after the expiration of the HSR waiting period. This trend is not limited to the United States, as it mirrors more rigorous merger control reviews occurring across the globe.

Although dealmakers and practitioners need to keep the new regulatory environment in mind when undertaking individual transactions, it is unlikely that overall PE deal activity in 2022 will be significantly affected by this shift as long as debt financing markets remain reasonably robust—although increasing interest rates could represent a modest headwind. Sponsors continue to sit on a record stockpile of $2.5 trillion in dry powder, and even larger successor funds are waiting to launch. In addition, the clock is currently ticking on almost 600 SPACs that need to get a deal done, offering a continued alternative path to exit for sponsors—though the effects of a recent Delaware Chancery Court decision suggesting that SPAC mergers may generally be subject to the enhanced scrutiny of "entire fairness" review have yet to be seen. (See our recent coverage, "Delaware Court Holds de-SPAC Transaction Subject to Entire Fairness.") Although there exists the ever-present possibility of another unforeseen, pandemic-like event disrupting deal flow, from where we sit, it appears deal activity will continue at an elevated rate into 2022.

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The past year saw significant M&A activity in Europe, with more than 1,100 private equity buyouts and more than 600 exits during the first half of 2021—nearly double the activity levels in the same period of 2020. This heightened activity took place despite an increasingly challenging political backdrop. In the UK, take-privates of supermarket chains Asda and Morrisons (with Debevoise advising CD&R on debt financing for the latter) were criticized by politicians for threatening the UK's food security when supply chains were already under pressure. Meanwhile, Advent's takeover of Ultra Electronics came under fire for potentially undermining the UK's national security.

These and other examples of increased economic and political uncertainty have prompted more European buyers to incorporate into agreements protection mechanisms that have historically been much more prevalent in the United States and elsewhere. Material adverse change provisions and termination rights for failure to obtain regulatory or antitrust clearances have become more common in a market in which buyers typically have not had meaningful walkaway rights.

Investors are also having to navigate tighter controls on foreign investment—most notably, the National Security and Investment Act 2021, which came into force on January 4, 2022. The Act introduces a mandatory notification system for certain acquisitions that involve 17 sensitive sectors of the UK economy, as well as a parallel voluntary regime for transactions that may otherwise give rise to national security concerns. It remains to be seen whether and how the new Investment Security Unit ("ISU") uses its powers, but the Act provides for significant sanctions for missed filings and an extensive ability to call in completed deals. While the ISU expects to receive between 1,000 and 1,800 notifications a year, the UK Government has been at pains to stress that the vast majority will be quickly cleared and that the UK remains firmly open to investment.

TMT, healthcare and pharmaceuticals were the dominant sectors for European M&A activity, and we expect that this will continue into 2022. However, the high level of competition for attractive targets within these sectors has led to PE deal making in other areas. Examples include Blackstone and Global Infrastructure Partners' acquisition of Signature Aviation, a private jet services operator, and Starwood's takeover of CA Immo, an office properties developer and manager.

We predict European M&A deal flow will continue to be strong in 2022 for a number of reasons. PE funds still have access to large amounts of dry powder. The winding down of governmental and EU support packages will generate more distressed opportunities. We expect an increase in carve-outs as companies seek to shore up their balance sheets by divesting noncore assets. The UK remains an attractive investment venue due to Brexit and COVID-19's impact on exchange rates and public market valuations, and activity in Germany remains strong. While the outlook for SPAC activity in the United Kingdom remains tepid, SPAC activity in continental Europe is expected to increase in light of well-received regulatory reforms implemented with the intention of attracting a greater number

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M&A (Europe)

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of SPAC listings. And the successful adaptation of PE buyers to virtual due diligence makes deal flow more resilient in the face of the pandemic's continued uncertainties.

At the same time, there will be challenges. Large amounts of dry powder means heated competition—and in many cases, inflated multiples—for the most attractive targets. In response, the new year could very well see more PE buyers acting together to acquire targets in consortium bids.

There are also storm clouds on the macro side. Worrisome levels of inflation at the end of 2021 have already led several central banks to raise interest rates. The effect of the Omicron variant on the global economy remains to be seen, with the prospect of returning to lockdowns looming over many sectors, notably hospitality.

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Continuing a recovery in activity that began in late 2020, Asia-Pacific deal volume more than doubled in value in the first nine months of 2021 compared with the same period in 2020. This rebound was driven in part by the significant amount of dry powder available to private equity and venture capital, which has increased by almost 300% in the past decade. While much of the region's deal activity was focused in China, 2021 also witnessed a significant increase in investments and interest in Southeast Asia and India. Whether this is the beginning of a meaningful geographic reshuffling of investment activity in the Asia-Pacific region remains to be seen, especially in light of current and expected geopolitical and regulatory developments.

While buyouts and other acquisitions are an important component of private equity deal activity, the primary route into the Asia-Pacific market remains venture capital, growth equity and other minority investments. Corporate governance reforms and rising shareholder activism also spurred corporate divestitures, including carve-out transactions, such as Takeda Pharmaceutical's sale of its consumer healthcare business unit. Technology, media and telecom transactions outshone other sectors, accounting for 43% of deal value in the first nine months of 2021. In particular, the ongoing wave of investments in the fintech sector, as well as consolidation in the sector from growing businesses acquiring new competencies—exemplified by U.S. payments business Square's $26.6 million acquisition of Australia's Afterpay—were key deal drivers. In the shadow of the continuing COVID-19 pandemic, healthcare deals naturally remained in high demand, with pharma, medical and biotech sectors in overdrive to develop vaccines, treatments and tests. The financial services, real estate, energy and mining and consumer/retail sectors rounded out the bulk of the remaining deal activity.

Investor confidence in the region was dampened by geopolitical tensions and related regulatory developments. U.S. executive orders issued under the Trump administration in November 2020 prohibited Americans from investing in companies

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M&A (Asia)

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with suspected ties to the Chinese military, eventually leading to the delisting of three Chinese telecom companies traded on the NYSE. The Biden administration has since added additional Chinese companies to this list, including entities operating in artificial intelligence, semiconductor, technology and other sensitive areas. Tensions between China and India have had an impact on cross-border investment flows between the two Asian giants, with the change in the Indian government's foreign direct investment policy via Press Note 3 continuing to figure prominently in any transaction involving (or implicating) entities or funding from China.

Regulatory developments on both sides of the Pacific generated further concern. In the United States, the Holding Foreign Companies Accountable Act, passed in 2020, is expected to lead to new SEC rules that will result in Chinese firms delisting from U.S. exchanges and re-listing on stock exchanges in Hong Kong and China. New Chinese cybersecurity regulations implemented in the aftermath of Didi Global's NYSE listing in June 2021 are expected to further incentivize Chinese companies to seek listings closer to home. These developments are expected to affect exits as well as transaction planning and structuring for private equity and other investors. The development of special purpose acquisition companies in Asia could provide an additional exit option, as both the Hong Kong Stock Exchange and the Singapore Stock Exchange recently revised their rules to permit SPAC listings.

Finally, GP-led secondaries, which have been a major feature in the U.S. and European markets over the last 18 months, have continued to gain prominence as an exit option. While most of these deals involve restructurings of dollar-denominated funds, a potentially significant development is the emergence of deals involving renminbi-to-dollar restructurings, where GPs sell assets in a renminbi-denominated fund into a dollar-denominated vehicle (typically through a qualified foreign limited partnership structure under Chinese law, which allows select foreign institutional investors to invest onshore in renminbi with capital raised offshore).

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The impact of the pandemic on Latin America's GDP has subsided with the increase in COVID-19 vaccination rates; the IMF now projects 2021 GDP growth for the region to reach 6.5%. So it is that 2022 promises to be an active year in the region for private equity, even in the face of ongoing compliance, regulatory and political challenges.

Private capital investment—particularly early-stage venture capital—remains dominated by the tech industry. For example, Softbank recently launched its second Latam fund, committing $3 billion to the region's tech industry. Nubank, the Brazilian fintech giant, raised $2.6 billion through an IPO, giving it a market capitalization of more than $40 billion and making it the largest financial institution in the region.

The SPAC market also picked up in the second half of 2021. Semantix, a São Paulo-based software company, and Procaps, a Colombian healthcare and pharmaceutical company, announced combinations with SPACs, while LatAm Growth SPAC, targeting high-tech growth companies in the region, filed with the SEC to raise up to $130 million in its IPO.

Private equity sponsors will continue to look to technology, given the exponential growth of early-stage and growth-equity investments, better exit opportunities, greater penetration by Latin American technology firms in the broader global market and the overall maturation of the sector. However, we are also observing increased interest and activity in other areas including the infrastructure, renewables, education, healthcare and asset management sectors.

In a June 2021 research report, the Spanish consulting firm Auxadi forecast that 91 % of North America-based GPs intend to commit capital in Latin America by 2026. At the same time, significant uncertainties cloud the horizon, including the ramifications of the upcoming elections in Brazil and in Colombia in 2022, the specter of higher inflation, and the rise of the Omicron variant.

CFIUS

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The Committee on Foreign Investment in the United States ("CFIUS") has been operating with significantly expanded jurisdiction, as well as enhanced resources and enforcement authority, for almost two years, since the promulgation in February 2020 of the final regulations implementing the Foreign Investment Risk Review Modernization Act ("FIRRMA"). As reported in our *2021 Private Equity Midyear Review and Outlook*, private equity fund sponsors have had to pay closer attention to CFIUS considerations at various points in the investment life cycle, from ensuring that investments by foreign limited partners fit within available CFIUS safe harbors to managing sales processes of portfolio companies involving foreign bidders. The following trends came into sharper focus:

- *The short-form declaration, which was introduced by FIRRMA, continues to gain traction as an alternative to a notice filing.* As discussed in the 2021 MYRO, declarations provide the potential to shorten CFIUS review of a transaction to 30 days, which in some circumstances allows for shorter periods to closing. Parties are more frequently taking this path: According to CFIUS's most recent annual report, the number of declarations increased in 2020 by 34 percent over the previous year while the number of notices fell by 21 percent. Of the 126 declarations submitted in 2020, 81 transactions (64 percent) were cleared at the declaration stage, 28 (22 percent) were required to submit a notice, 16 (13 percent) received a "shoulder shrug" (*i.e.*, neither an approval nor a disapproval from CFIUS), and one was withdrawn. Based on case numbers assigned to declaration filings made at the end of 2021, we expect that the total number of declarations that were submitted in 2021 will be substantially higher. This reflects parties' growing comfort with the declaration process and its ability to deliver on its promise of shorter review periods ending with final determinations.

- *The declaration process is better suited to certain fact patterns.* Declarations may be better suited to transactions that have one or more of the following characteristics: (i) the U.S. business does not involve particularly sensitive industries (*i.e.*, those involving critical technology, critical infrastructure or sensitive personal data), (ii) where the foreign buyer is from an allied country or is a "frequent flyer" with a successful track record before CFIUS, or (iii) where issues of CFIUS jurisdiction are more technical in nature (*e.g.*, the buyer is U.S. based but is directly or indirectly controlled by a benign foreign person through a governance right that, in the CFIUS sense, constitutes "control").

- *Declarations should be taken seriously.* Whether to file a voluntary declaration instead of a notice is often a close judgment call, which may turn on the buyer's desire for an assurance of outright CFIUS approval (as opposed to a "shoulder shrug"). Or, it may be driven by the expectation that CFIUS might wish to be in a position to negotiate mitigation measures, in which case, it might require, at the end of the declaration review period, that the parties file a notice. In considering the declaration option, however, buyers should remember that the declaration process is not without

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CFIUS

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challenge. Parties may wish to submit information to CFIUS that does not have an obvious home in the declaration template, which will often require the drafting of substantial exhibits. At the outset of the process, CFIUS can decide not to accept a declaration on the basis that it is incomplete, thereby delaying the commencement of the 30-day review process until the perceived defect can be remedied. Finally, when reviewing a declaration, CFIUS may well ask detailed questions of the nature it would ask if it were reviewing a notice. During the declaration review process, however, parties only have two business days to respond to a question, rather than the three business days available during the review of a notice.

- *CFIUS is actively monitoring transactions*. The Monitoring & Enforcement unit of the U.S. Treasury Department's Office of Investment Security, whose tasks include identifying transactions not notified or declared to CFIUS but that nonetheless implicate U.S. national security concerns, has grown significantly and coordinates across the U.S. government to proactively identify transactions it considers to warrant review. In 2020, CFIUS reviewed 117 transactions that were identified through this process and requested notices to be filed for 17 (14 percent) of those. Although the Office's focus has reportedly been on transactions involving Chinese and Russian investors, it has wide authority over transactions involving any non-U.S. investor. As Chinese and Russian investment in the United States continues to decline, it seems reasonable to assume that Monitoring & Enforcement will scrutinize a broader range of transactions, especially those that raise more obvious national security concerns or where the foreign buyer is not a known or trusted entity.
- *CFIUS-related provisions are more prevalent in fund documents*. We continue to see in fund-related documents an increase in fund sponsors' use of prophylactic terms aimed at ensuring that limited partners have no control rights over the general partner or the fund and that investors do not have any of the three trigger rights that are elements of a noncontrolling "covered investment." CFIUS's regulations do not require including such provisions in fund documentation. Nonetheless, they may provide some comfort to fund managers and limited partners that an investment by a fund with one or more foreign investors will not inadvertently come within CFIUS's jurisdiction.

CFIUS considerations now have heightened importance for private equity fund sponsors throughout the investment life cycle. Our CFIUS team would be glad to discuss any of these topics further.

U.S. Capital Markets

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We discuss below three recent actions by the SEC affecting capital markets that may be of particular interest to private equity firms and portfolio companies.

SEC Proposes Significant Amendments Regarding 10b5-1 Trading Plans and Trading-Related Disclosure Requirements

In December 2021, the SEC proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, and proposed new disclosure requirements relating to trading activity of corporate insiders and issuers. The proposed amendments, if adopted, would add significant new conditions to the availability of the affirmative defense to insider trading liability under Rule 10b-5 for purchases and sales of securities pursuant to trading plans that satisfy the requirements of Rule 10b5-1(c)(1). These conditions include a minimum 120-day cooling-off period for directors and Section 16 officers after the date of adoption or modification of any Rule 10b5-1 plan before any purchases or sales under such plan could commence, and a written certification by directors and Section 16 officers that at the time of such adoption or modification, they are not aware of any material, nonpublic information about the issuer or its securities, and they are adopting the plan in good faith. An issuer that adopts a Rule 10b5-1 trading plan would be subject to a 30-day cooling-off period.

The proposed amendments would also create new disclosure requirements regarding: (i) the adoption, modification and termination of Rule 10b5-1 and other trading arrangements by issuers and directors and Section 16 officers; (ii) insider trading policies and procedures of issuers; and (iii) the timing of equity compensation awards to named executive officers or directors made in close proximity to the issuer's release of material, nonpublic information. In addition, the proposed amendments would augment the reporting obligations under Section 16 of the Exchange Act of transactions made pursuant to a Rule 10b5-1 plan and require that gifts be reported within two business days on a Form 4, rather than following the end of the year on a Form 5.

SEC Proposes Major Amendments to Share Repurchase Disclosures

In December 2021, the SEC proposed a new rule that would significantly expand required disclosures concerning an issuer's repurchase of its equity securities listed on a U.S. stock exchange. The proposed rule, if adopted as proposed, would require detailed daily disclosure of share repurchases on a new Form SR, which would include the number of shares repurchased, the average price per share, the number of shares purchased on the open market and the number of shares purchased in reliance on safe harbors under the U.S. federal securities laws. The proposed rule would also increase the required disclosure in an issuer's periodic Exchange Act reports on share repurchase activity, including details on the structure of a repurchase program, the objective or rationale for share repurchases, the process or criteria used to determine the amount of repurchases and any policies or procedures relating to trading by directors and officers during a repurchase program.

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U.S. Capital Markets

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Nasdaq Board Diversity Listing Rule Approved

In August 2021, the SEC approved new Nasdaq listing rules that require all companies listed on Nasdaq's U.S. exchange to publicly disclose diversity statistics regarding their board of directors no later than August 2022, with many Nasdaq-listed companies expected to include diversity statistics in their 2022 proxy statement. The rules also require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an "underrepresented minority" or "LGBTQ+." Nasdaq-listed companies are required to have one such diverse director by August 2023 and at least two diverse directors by August 2025.

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For the private equity industry, the publication of rules establishing Qualifying Asset Holding Companies ("QAHCs") was the biggest UK tax development of 2021. This regime, which comes into force in April 2022, is hugely significant, as it aims to reposition UK resident companies as fund investment holding platforms. We review this and two of the year's other notable UK tax-related events below, as well as briefly addressing important international tax developments known as "BEPS 2.0" and "ATAD 3."

QAHCs

The UK QAHC regime, as its name suggests, contains certain qualifying criteria. Broadly, QAHCs must be UK resident, principally involved in private investment activity and at least 70 percent owned, directly or indirectly, by certain categories of investor. Such investors include "relevant qualifying funds" as well as public authorities, pension schemes, charities, sovereign entities, UK REITs and their international equivalents, other QAHCs, and UK- or non-UK-authorized long-term insurance businesses. "Relevant qualifying funds" will be the most important category from the point of view of analyzing the suitability of the QAHC as an investment holding platform for funds. These are, in summary, collective investment schemes which meet the genuine diversity of ownership ("GDO") condition and collective investment schemes (including those which do not meet the GDO condition) or alternative investment funds which are not "close" under UK law. While many funds are collective investment schemes that readily fall within the first category, a sizeable minority do not. Such funds will be reliant on the "non-close" test, which is not easily applied to fund structures. Since this aspect of the rules has been the target of some criticism for presenting unnecessary technical challenges, it remains possible that it may be changed.

If the ownership criteria are successfully met, the QAHC is eligible for preferential UK tax treatment tailored to holding vehicles. Gains are generally exempt from tax, payments of both interest and dividends can be made free of withholding, share buy-backs by a QAHC do not attract stamp duty, and, crucially, gains repatriated to investors by means of share buy-backs retain their character as gains and are not treated as income distributions. This tax treatment amply addresses the UK's disadvantages as a holding company jurisdiction and creates a highly competitive regime which, when combined

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UK Tax

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with the English limited partnership as a fund vehicle, ought to render the United Kingdom an attractive prospect for fund managers.

In light of these reforms, there now is much debate regarding whether the new UK QAHC or the established Luxembourg system is the better option. In truth, this will vary depending on circumstance. Tax never exists in a vacuum, and wider issues, both tax and non-tax, will be important. Some of these issues could be addressed during the United Kingdom's ongoing, broader review of its approach to investment funds, which will include an upcoming consultation on VAT and funds. Regulatory considerations are also a significant factor when deciding between the two jurisdictions. For these reasons, some EU investors may simply prefer an EU structure. Nonetheless, industry response to the QAHC and interest in utilizing it have proved very positive.

Capital Gains Tax

Following some uncertainty over the future of capital gains tax arising from two reports by the Office of Tax Simplification ("OTS"), HM Treasury stated in a November letter to the OTS that there were no current plans to alter the system. This is welcome news, since there had been concerns that there may be a move to align the taxation of gains (including carried interest and co-investment) with income.

Tax Rate Increases

On a less favorable note, there will be 1.25 percent increases to National Insurance Contributions (the UK social security system) and dividend tax rates in April, and a corporation tax increase (from 19 percent to 25 percent) in 2023.

Certain International Developments: BEPS 2.0 and ATAD 3

In 2021, the OECD launched various publications relating to its proposal to address the taxation of the digital economy, commonly referred to as "BEPS 2.0," which could result in fundamental changes to the international tax system. The most recent, in December, were model domestic "Global anti-Base erosion" or "GloBE" rules aimed at implementing a global minimum tax at an effective rate of 15%. Model tax treaty provisions, which will operate alongside the GloBE rules, together with further commentary, are expected early in 2022. The GloBE rules are extremely complicated and, while it is known that investment funds and their managers are not specifically targeted, certain larger fund houses will be required to apply consideration to relevant provisions as they develop, as will many institutional investors.

Separately, at around the same time, the European Commission published a draft directive, commonly referred to as "ATAD 3," aimed at addressing perceived abuse by "shell" companies claiming treaty or other benefits. This directive would require companies with certain risk indicators to meet and report specific criteria to counter "shell" company status, failing which such companies may be denied treaty residence certificates. This directive would, if implemented, require consideration in respect of some investment fund holding structures. However, it has been the subject of technical criticism and, in any case, must be unanimously approved by EU member states in order to pass into law; as such, it may be altogether premature to be alarmist about ATAD 3 in its current form.

SEC Enforcement

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As expected, the SEC has renewed its focus on private funds, with both SEC Chair Gary Gensler and Director of Enforcement Gurbir Grewal publicly indicating their interest in the space, particularly as it relates to fund management and disclosures.

In November, in a speech pushing back on the notion that the SEC is "regulating by enforcement," Director Grewal highlighted the Commission's focus on fund disclosures related to ESG issues—now a regulatory topic *du jour*. Grewal explained that the Commission, through the Enforcement Division's Climate and ESG Task Force formed last year, is applying "long-standing principles regarding fiduciary duties and honest disclosure" to assess the marketing and management of ESG funds and strategies. To illustrate his view that SEC enforcement scrutiny of asset managers' ESG disclosures is not a "new mandate," Grewal cited a settlement from 2008, *Pax World Management*, in which the firm allegedly failed to comply with its disclosures to investors about the types of securities in which it would invest and thereby breached its fiduciary duty to follow "socially responsible investing restrictions." In addition, in April 2021, the Division of Examinations issued a Risk Alert on similar disclosure and fiduciary issues in the ESG space. Given that the exam staff's Risk Alerts typically signal ongoing or imminent Enforcement activity, it is no surprise that clients have received ESG-related inquiries, and we expect enforcement actions to follow.

In addition to issues around ESG disclosure, Chair Gensler has publicly expressed concern about how high fees charged by private fund managers affect the overall economy and whether "competition and transparency" could bring greater efficiencies to the private fund arena. Gensler noted that "basic facts about private funds are not as readily available" to the public or to investors, unlike the fee transparency with mutual funds. Gensler also noted that, unlike with registered and index fund fees, private fund fees have not decreased over the years and instead have remained remarkably stable. Furthermore, Gensler questioned whether increased regulation of private fund side letters is warranted, suggesting that such agreements could create an uneven playing field among investors. Gensler also noted that fiduciary duty waivers commonly included in private fund agreements might violate the Advisers Act. This represents a sharp departure from the Clayton Commission, which was reluctant to intervene in the arms-length contractual negotiations between sophisticated investors and private fund managers.

To that end, the SEC brought a first-of-its-kind action on January 11, finding that a firm's use of a liability disclaimer, or "hedge clause," in its advisory agreements violated the antifraud provision of the Advisers Act. The hedge clause in question purported to relieve the firm, Comprehensive Capital Management (CCM), of liability related to "any act" on its part, while simultaneously stating that the clause did not constitute a waiver of a client's rights under the federal securities laws. The SEC noted that these hedge clauses could mislead retail clients into not exercising their legal rights, despite the fact that certain rights are non-waivable. Though such clauses are commonly inserted in advisory agreements, this is the first enforcement action since the SEC published the

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SEC Enforcement

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Commission Interpretation Regarding Standard of Conduct for Investment Advisers, IA Rel. No. 5248 (June 5, 2019), which stated that exculpatory hedge clauses are nearly always inconsistent with antifraud provisions of the Advisers Act. Notably, CCM attempted to revise its hedge clause after the publication of the Commission Interpretation, but the SEC found both the original and the revised hedge clause to violate Section 206(2) of the Advisers Act. CCM's other alleged violation and its status as a repeat offender presumably made it easier for the Commission to conclude that the waiver was worthy of enforcement, but the case may nonetheless be the opening salvo in a broader enforcement push against liability waivers.

In addition to recent concerns expressed by Chair Gensler and Director Grewal about private fund fees, in December 2021, the SEC filed a settled administrative proceeding finding that a private equity manager had not offset fees received by the manager from a portfolio company against fund-level management fees, as required by the fund's governing documents. Although the theory of liability was not novel, the matter demonstrates the Gensler Commission's interest in continuing to pursue private equity fee and expense cases.

U.S. Regulatory

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The updated regulatory agenda issued by the SEC in the fall of 2021, along with speeches by SEC Chair Gary Gensler and other officials during the second half of the year, suggest that there will be no letup in the Commission's intense scrutiny of the private equity and private fund space. We highlight key issues below.

Private Fund Disclosure

Chair Gensler's speech at the Institutional Limited Partners Association ("ILPA") Summit in November 2021 highlighted his continued focus on increasing transparency in the private equity market. This focus was reinforced one month later in the SEC's fall regulatory agenda, which included a new rule proposal under the Investment Advisers Act applicable to private fund advisers. Based on these developments, we anticipate that the SEC will focus on requiring funds to provide additional information across several, and sometimes new, areas including:

- *Side Letters:* Potentially requiring disclosure of side letters or prohibiting certain side letter provisions.
- *Fee Arrangements:* Increasing transparency regarding private fund fee arrangements, including in regards to management fees, performance fees and portfolio company fees.
- *Fund Performance Metrics:* Enhancing transparency (and potentially, consistency) around private fund performance metrics.

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Chair Gensler also noted that the SEC is reviewing how to mitigate conflicts of interest between general partners, their affiliates and investors and possibly increasing reporting and disclosure through changes to Form PF. In regards to conflicts of interest and fees, advisers are required to provide information about the funds and certain conflicts of interest in their Form ADV filings and in materials provided to clients and fund investors. Private funds are required to provide some fund information (unrelated to fees and conflicts specifically) to the SEC on Form PF and Form D filings. We expect that the SEC may make changes to these filing requirements or may adopt new disclosure requirements specific to fees, expenses and conflicts, potentially as part of the new private fund advisers rule proposal.

SEC Releases Latest Regulatory Flex Agenda

The SEC's latest regulatory agenda lists several items, currently slated as proposed rules, which could affect investment advisers in the coming year, including:

- *Updates to Rules Related to Private Fund Advisers:* As noted above, a proposal to update the Investment Advisers Act with new rules applicable to private fund advisers, likely on topics such as transparency, conflicts of interest and fund fees. This is a new proposal, as the SEC's spring regulatory agenda did not include any such item. This rule is likely to be proposed in the second quarter of 2022.
- *Amendments to Form PF:* Potential amendments to Form PF, likely to be proposed in the first half of 2022.
- *Climate Change Disclosure:* Proposed rules to enhance disclosures regarding issuer's climate change risks and opportunities, likely to be proposed in the first half of 2022.
- *Rules Related to Investment Companies and Investment Advisers to Address Matters Relating to Environmental, Social and Governance Factors:* Proposed new rules setting out new requirements for investment companies and investment advisers related to ESG factors, including ESG claims and disclosures. This rule is likely to be proposed in the second quarter of 2022.
- *Revisions to the Definition of Securities Held of Records:* Potential amendment to the "held of record" definition for purposes of Section 12(g) of the Securities and Exchange Act of 1934, which could require private fund portfolio companies, and the funds themselves, to file public reports under the Exchange Act. This rule is likely to be proposed in the fourth quarter of 2022.

Proactive Compliance and SEC Enforcement Principles

- Throughout the fall of 2021, Chair Gensler and the new Director of the Division of Enforcement, Gurbir Grewel, both gave speeches emphasizing the importance of

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proactive compliance on the part of private market participants. In addition, they both stated that market participants, such as investment advisers or lawyers, who push the limits of ambiguous regulatory issues could increasingly face the risk of enforcement due to the SEC's focus on addressing potential risks before potential investor harm occurs.

- In addition, Grewal's speech emphasized his view on the importance of imposing significant penalties to deter misconduct. We expect that the Division of Enforcement may seek larger enforcement penalties than before, particularly for repeat offenders.

Investment Adviser Act Marketing Rule – Upcoming Compliance Deadline

Finally, as discussed in the *2021 Private Equity Midyear Review and Outlook*, advisers registered under the Investment Advisers Act must comply with the new Marketing Rule by November 4, 2022—less than a year away. Registered advisers who are currently engaged in fundraising or active marketing should develop a commercially feasible time frame for transitioning to the new Marketing Rule. Our summary of the Marketing Rule is available here.

* * *

Given the activity since Chair Gensler's appointment last year, we expect 2022 to be a period of intensified U.S. regulatory activity for private equity advisers and the investment management industry.

European Funds Regulatory

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Last year saw a number of important regulatory developments affecting European fund managers and investors, including proposals to review existing regulations and to establish standards and guidelines to clarify implementation. We review some of the most important of these developments below.

AIFMD Review

The European Commission recently published its long-anticipated proposal to amend, amongst others, the Alternative Investment Fund Managers Directive ("AIFMD"). The proposal targets specific amendments to the AIFMD and does not involve a wholesale review. Highlights include a new regime for loan origination funds and further focus by the European Securities and Markets Authority ("ESMA") on AIFM delegation arrangements, liquidity management tools and additional pre-contractual disclosure requirements. At this early stage, the proposal acts as an agenda of areas of concern and will be subject to scrutiny and negotiation with the European Council and Parliament, with its final form diverging to an unknown extent from the Commission's proposal.

ELTIF Review

On November 25, 2021, the Commission published a proposal for review of the Regulation on European Long-Term Investment Funds ("ELTIF"). The regulation is intended to facilitate the raising and channelling of capital towards long-term investments in the real economy, reflecting the European Union's goal of smart, sustainable and inclusive growth. The most significant proposed changes are:

- broadening the scope of the regulation;
- easing requirements covering ELTIFs exclusively marketed to professional investors;
- broadening the eligible assets in which ELTIFs may invest (for example, allowing ELTIFs to make co-investments and invest in EU funds managed by EU AIFMs); and
- removing specific requirements applicable to ELTIFs distributed to retail investors.

These changes, if adopted by the EU Parliament and the Council of the European Union, would strengthen the attractiveness of ELTIFs to fund both managers and investors.

ESG

Environmental, social and governance ("ESG") standards were also a hot topic in 2021. In October, the European Supervisory Authorities' ("ESA") published its final report on the draft Regulatory Technical Standards ("RTS") called for by the Sustainable Finance Disclosure Regulation ("SFDR"). The standards aim to establish a single rulebook for sustainability disclosures under the SFDR and the Taxonomy Regulation. The final draft includes new pre-contractual and periodic disclosure templates, in particular for sub-categories of Article 8 and 9 SFDR financial products. In addition, taxonomy-aligned investments are now subject to the SFDR's "do no significant harm" principle.

The Commission intends to adapt all previously published SFDR-related RTS into one instrument that will apply from January 1, 2023.

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European Funds Regulatory

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Cross-Border Distribution of Funds Directive and Impact of Pre-Marketing

On August 2, 2021, the new EU pre-marketing rules of the EU Cross-Border Distribution of Funds ("CBDF") legislation came into effect. But because few EU member states apply the new pre-marketing rules to non-EU AIFMs, there is no harmonized pre-marketing regime available for non-EU AIFMs—in complete contrast to the intent of the CBDF. Currently, only Germany and Luxembourg apply the new pre-marketing rules to non-EU AIFMs by covering non-EU AIFMs in the pre-marketing definition and requesting a pre-marketing notification by non-EU AIFMs. Other EU member states have either not yet implemented CBDF (neither for EU nor for non-EU AIFMs) or their implementation does not cover non-EU AIFMs. As a consequence, some member states, such as Denmark and Ireland, seem to take the position that pre-marketing by non-EU AIFMs is not permitted; other member states just apply their "old" pre-marketing rules, which may diverge from member state to member state. We will have to see how the remaining EU (and EEA) member states will implement the CBDF into national law, but hopefully they will apply the new pre-marketing rules to non-EU AIFMs in order to have a uniformed and harmonized pre-marketing regime within the EEA.

ESMA Marketing Communication Guidelines

In May 2021, ESMA issued its marketing communication guidelines under the Regulation on Cross-Border Distribution of Funds. The guidelines are broad in scope and should be applied to all marketing communications—whether print, electronic documents or posted online—addressed to investors or potential investors for UCITS and AIFs. However, the guidelines clarify that legal and regulatory documents such as prospectuses or disclosure information under Article 23 AIFMD should not be considered as marketing communications within the meaning of the guidelines. The guidelines include special requirements and limitations regarding the presentation of costs and expenses, track record and expected future performance, and risk and reward. Although information issued in the context of pre-marketing is explicitly exempted from the scope of the guidelines, any communications issued by a manager after the pre-marketing phase should conform to the guidelines to ensure consistency. These guidelines will become applicable from February 2, 2022.

ESG

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The year 2021 saw significant ESG developments, from global goal setting to the creation and further development of corporate ESG due diligence and disclosure regimes. Below, we build on the ESG highlights we described in the *2021 Mid-year Review and Outlook* and review the developments from the second half of the year that may further the ESG agenda for fund managers and investors in 2022 and beyond.

International Organizations

The various commitments, agreements and pledges that came out of the United Nations' annual climate change conference held in Glasgow in November 2021—colloquially known as COP26—may influence ESG regulation for years to come. For example, in the Glasgow Climate Pact, nearly 200 countries agreed to address seven topics: science and urgency, adaptation, mitigation, finance, loss and damage, implementation, and collaboration. The Pact calls upon the Parties to accelerate "the phasedown of unabated coal power and phase-out of inefficient fossil fuel subsidies…." In addition, more than 100 world leaders pledged to end and reverse forest loss and land degradation by 2030, and more than 100 countries signed up to an initiative of the United States and the European Union to cut anthropogenic emissions of the greenhouse gas methane by 30 percent by 2030, measured against 2020 levels.

COP26 also saw the Glasgow Financial Alliance for Net Zero commit more than $100 trillion toward achieving net-zero greenhouse gas emissions. Furthermore, the IFRS launched the Foundation of the International Sustainability Standards Board to develop sustainability-related disclosure standards that provide investors with high-quality, comparable reporting by companies on climate and other ESG issues. (More information on these initiatives, and on further agreements and commitments, can be found in our in-depth: *What happened at COP26?*)

United States

SEC. In September 2021, the SEC Staff released a "Sample Letter to Companies Regarding Climate Change Disclosures." The letter, providing comments to a hypothetical publicly traded company, is a useful window into the types of disclosure issues companies can expect the Staff to scrutinize. Those issues include alignment between a company's SEC filings and its CSR reporting to investors and the disclosure of material climate change-related risks due to transition and litigation, federal and state regulatory developments, international treaties and changes to markets and operations. The sample letter is particularly timely given reports that the SEC has been sending an increasing number of comment letters to companies related to their climate change disclosures.

The release of the Sample Letter follows the SEC's announcement in March of the creation of a Climate and ESG Task Force in the Division of Enforcement. This Task Force will seek to identify material gaps or misstatements in reporting companies' disclosures of climate risks. As Enforcement Director Grewal indicated in a recent speech, the SEC currently views scrutiny of ESG disclosures as a straightforward application of

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conventional theories targeting false or misleading statements in disclosure filings rather than a new development vulnerable to charges of "regulation by enforcement."

In November, the SEC issued Staff Legal Bulletin No. 14L, limiting the ability of public companies to exclude from proxy statements shareholder proposals on significant social issues. With this guidance, the number of ESG-related shareholder proposals, which had grown significantly in 2021, is expected to increase even further in 2022.

FTC. The U.S. Federal Trade Commission has begun asking questions related to ESG in its antitrust reviews, a development that signals a new front in ESG regulatory activity in the United States.

DOJ. In October, the U.S. Department of Justice announced several changes to its corporate enforcement policies that increase risks for companies, including potentially when making ESG-related disclosures. As part of its charging decisions, DOJ now will consider all of a company's prior misconduct—whether criminal, civil or regulatory in nature and whether or not that misconduct is similar to the issue being investigated—on the theory that "the record of misconduct speaks directly to a company's overall commitment to compliance programs and the appropriate culture to disincentivize criminal activity." This policy could result in DOJ considering ESG-related infractions—such as inconsistent or misleading disclosures—when determining sanctions for non-ESG-related violations, and vice versa. Companies thus face additional pressure to handle appropriately various ESG-related matters, including ensuring that related disclosures are accurate, complete and not misleading. Illustrating this broadened ESG risk, DOJ recently informed Deutsche Bank AG that the bank may have violated conditions of an earlier criminal settlement by not disclosing an internal complaint alleging that its asset management arm overstated its use of ESG criteria in managing assets classified as sustainable investments.

Nasdaq. In August, the SEC approved Nasdaq's proposed new listing rules, which included measures intended to advance board diversity at Nasdaq-listed companies. Under the new rules, Nasdaq-listed companies will be required annually to disclose information related to their board's self-identified gender and racial characteristics and LGBTQ+ status. Nasdaq-listed companies also will be required to include on their board a specified number of diverse directors or to publicly state why they have not done so.

Regulation of PFAS. The Biden Administration is taking steps to regulate per- and polyflouroalkyl substances ("PFAS") because of their impact on human health and the environment. Commonly referred to as "forever chemicals" because of their inability to break down in the environment, PFAS chemicals are used to make products resistant to oil, water and heat, such as carpeting, cookware, clothing, packaging and firefighting foam.

On October 18, 2021, the United States Environmental Protection Agency ("EPA") released its PFAS Strategic Roadmap, which seeks to prevent releases of PFAS chemicals into the environment at unsafe levels and accelerate the remediation of PFAS contamination. Under the roadmap, the EPA proposes designating two PFAS chemicals, perfluoroctanoic acid ("PFOA") and perfluorooctane sulfonate ("PFOS"), as hazardous substances under

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the Comprehensive Environmental Response, Compensation and Liability Act. The designation would trigger the investigation of facilities at which release of such chemicals occurred and would enable the EPA to require responsible parties to remediate such facilities. In addition, under the PFAS roadmap, the EPA would propose new drinking water standards for PFOA and PFOS.

Over the last few years, with the threat of PFAS regulation looming, many investors have already begun evaluating PFAS-related risks. But with the Biden Administration now making clear it will regulate PFAS, all private equity firms should evaluate potential PFAS-related risks associated with their investments. These risks include obligations to investigate and remediate PFAS contamination, the phase-out of company products containing PFAS and claims alleging adverse health effects resulting from exposure to PFAS.

Europe

Disclosure Regulations. There has been further guidance on the scope of the Sustainable Financial Disclosure Regulation ("SFDR"), which is applicable to financial market participants. As we discuss in more detail in the section on European regulatory developments, the European Supervisory Authorities delivered in October their Final Report on draft Regulatory Technical Standards for disclosures under the SFDR, as supplemented by the Taxonomy Regulation. However, the European Commission has again postponed the RTS's application date, this time to January 1, 2023. In the wake of the Taxonomy Regulation, which informs what qualifies as "environmentally sustainable" under the SFDR, the EC has published a draft report on a Social Taxonomy, designed to inform reporting on additional social issues (the "S" of "ESG") under the SFDR and the Non-Financial Reporting Directive ("NFRD"), which is applicable to large corporates. The Commission has also adopted a proposal for a Corporate Sustainability Reporting Directive ("CSRD"), which would amend the existing reporting requirements of the NFRD.

In the UK, disclosure regulations have focused on climate change and the environment. The UK government published a policy paper setting out its plans for new economy-wide sustainability disclosure requirements ("SDR") to ensure "the information exists to enable every financial decision to factor in climate change and the environment." The Financial Conduct Authority published and will consult on a discussion paper on new SDR for asset managers and a new classification and labelling system for sustainable investment products.

Alongside COP26, the UK announced that it will be the world's first Net Zero-aligned Financial Centre. Asset managers, regulated asset owners and listed companies will be required to publish transition plans setting out how they will decarbonize. The government intends to incorporate these plans into the UK's SDR. Switzerland has also announced plans to introduce mandatory climate reporting. Public companies, banks and

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insurance companies with 500 or more employees, more than CHF 20 million in total assets or more than CHF 40 million in turnover will be required to report publicly on climate issues from 2024.

Mandatory Due Diligence Laws. The European Commission has delayed the publication of its Mandatory Human Rights Due Diligence Directive ("MHRDD") legislative proposal until sometime in 2022. In the meantime, 43 investors and companies issued a joint statement in support of meaningful and safe stakeholder engagement as a crucial aspect of the upcoming EU MHRDD framework—a key theme in discussions around the proposed legislation. For now, the guidance on forced labor in supply chains issued in July by the Commission and the European External Action Service "bridg[es] the time until legislation on Sustainable Corporate Governance is in place." It specifies key considerations for firms when putting in place procedures concerning forced labor, and practical guidance on what might qualify as a "red flag." And the delay of the MHRDD has not prevented national jurisdictions from pushing ahead with their own initiatives. As we reported in the *Mid-year Review and Outlook*, the Norwegian Parliament adopted its Transparency Law in June; the law is due to enter into force on July 1, 2022. The Dutch Law remains at an earlier stage, and its progress appears to have stalled.

In line with pledges at COP26, deforestation is a particular focus of recent legislative proposals prescribing due diligence obligations. These may be relevant to private equity firms active in the natural resources sector. In November 2021, the EC published its Proposal for a Regulation on deforestation-free products, and the UK's Environment Act 2021 received royal assent. Both regulations aim to reduce consumption of products coming from illegal deforestation, envisaging due diligence to mitigate the risk of noncompliance with national laws relating to particular commodities.

Data Strategy and Security

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Cybersecurity Incident Response Plans: Considerations for Review and Revision

Cybersecurity continues to be a major risk area for private equity sponsors and their portfolio companies. Because of this, regulators, insurers, auditors and investors continue to focus on incident response preparation as a primary means to mitigate those risks. Central to that preparation is creating and updating written incident response plans ("IRPs"), which can help companies think through how they would respond to an incident so that they are not addressing complex process issues for the first time under the stress of a crisis. While many companies have written IRPs, those plans are often long and wordy, overly technical, out of date compared with the current threat environment, and poorly designed for use in an actual incident. Further, IRPs can also be overly prescriptive and fail to give companies the flexibility they need when facing a dynamic and rapidly developing incident that might include new threat actors, vulnerabilities or cyber threats not accounted for in the IRP. Those companies would then be at risk of having to explain to regulators and others why the IRP was not strictly followed in the face of an incident and unanticipated developments.

Given these considerations, private equity sponsors and their portfolio companies may want to periodically review and revise their IRPs. Once the revised IRPs are in place, consider testing them with a tabletop exercise using a specific scenario to see whether the revised IRPs prove to be helpful during an incident.

Key considerations when evaluating and revising IRPs include the following:

- Ensure that the IRP is clear, practical and easy to use in an incident, and not too rigid.
- Consider creating separate checklists for specific types of incidents like ransomware, vendor breach, distributed-denial-of-service ("DDoS") attack, supply chain software compromise, cryptojacking, etc.
- Include draft internal and external communications.
- Include a roster of the incident response team and scope of responsibility for each member, scaling the composition of the team to the severity and type of incident. For example, some incidents, such as DDoS attacks and cryptojacking incidents, are likely to be run by the information security group, while data privacy incidents will draw heavily upon legal, compliance and privacy personnel.
- Ensure that steps are taken following an incident to address remediation, document the incident, and use lessons learned to update applicable policies, procedures and training.
- List contact information for outside resources that have been pre-vetted and on-boarded with the assistance of external counsel, such as crisis communications firms and third-party forensic experts.
- Identify potential regulatory and contractual breach notification obligations for various possible types of incidents.

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- Identify any applicable insurance and a point person to notify and coordinate with the insurer.
- Identify the appropriate law enforcement authorities who can provide assistance for certain incidents and establish a point of contact.
- Work with internal and external counsel to establish procedures for preserving evidence and issuing litigation holds, and memorialize these processes in the IRP.

Real Estate

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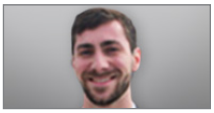

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As the rebound of the U.S. economy progresses despite COVID-19's persistence, real estate investment activity during 2021 has been strong, if uneven. Multifamily and single-family rents in markets nationwide continue to increase as inventories tighten; soaring logistics and warehouse property values supplement already impressive industrial sector gains; and tech and life sciences-focused developments maintain outsized growth. To be sure, not every sector has thrived—retail operators continue to shed debt-laden assets, office space investment has recovered only modestly and unevenly from pandemic lows, and hospitality faces prolonged headwinds from renewed travel restrictions prompted by the Omicron variant. Maintaining the real estate industry's overall health depends on sustaining a brisk deal pace in the face of the twin threats of inflation and COVID-19's ongoing structural impact on daily life.

Office sector investment activity still trails pre-pandemic levels, as first the Delta variant and now Omicron have delayed return-to-office plans. While overall leasing activity has declined during the pandemic, the leases that have been signed reflect a "flight to quality" and evolving work environment preferences, including health and sustainability upgrades, newer construction with brighter open and outdoor spaces adaptable to collaborative working styles, and tenant amenities like improved retail and dining offerings. Recent leases and transactions bringing tech giants and life sciences firms to spaces with a "campus" feel lend credence to expectations of a resurgent premium office market with the gradual return to offices.

Investors continue following family migration to suburban single-family homes, looking to capitalize on recovering rents that, in many metropolitan markets, have surpassed pre-pandemic levels as an ultracompetitive purchase environment pushes would-be homebuyers toward rentals. Multifamily and student housing asset classes also continue to receive investor attention, as the return to cities and colleges drives increased demand and ultra-low vacancy rates. As the nationwide dearth of homeownership opportunities persists, investors continue allocating to the sector as developers reap rewards from well-amenitized rental communities.

Commercial real estate transaction values in the latter half of the year reached notable highs alongside substantial rebounds in deal volume, sustained in part by overwhelming interest in industrial spaces. Despite spikes in construction material costs, the e-commerce boom has generated a flurry of new development and rising rents among warehouses and other logistics properties. The third quarter of 2021 saw the highest quarterly net absorption of industrial space since before 2008, further spurring explosive investor demand for properties essential to the supply, distribution and delivery chain.

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The pandemic upended daily life and the supply chains that keep commercial activity functioning, but this disruption also clarified shifting lifestyle and workplace preferences, resulting in a real estate market that continues to present significant opportunities to investors attuned to these evolving dynamics. The wild card ahead for investors is rising inflation and potential reactions to it. Even with the Federal Reserve positioned to curb inflation through interest rate increases, the recent uptick in merger activity involving hotels and resorts, where adjustable room rates offer daily hedges against inflation, signals that investors are already planning around this unknown.

Restructuring

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Last year was largely quiet for restructuring, as pandemic-associated fiscal and monetary policies, along with surging financial markets, afforded even stressed borrowers with ready access to new capital and caused existing lenders to be generally forgiving. For new borrowings, market competition led to the most borrower-favorable covenants in years—more than 90 percent of U.S. leveraged loans issued were covenant-lite, an all-time record. Accordingly, private equity sponsors could draw upon a wide assortment of tools to access funding, extend maturities and modify debt covenants for portfolio companies. In this environment, U.S. defaults and bankruptcy filings hit 15-year lows.

The one uptick for restructuring in 2021 involved heightened activity and interest in the use of bankruptcy to address complex mass tort liabilities. Attention focused on two major issues: whether a bankruptcy plan can provide third-party releases to non-debtors and whether a solvent entity may use a spin-off or demerger transaction to ring-fence troublesome liabilities into a subsidiary that files for Chapter 11, allowing non-troubled businesses to operate free of bankruptcy. Both litigation and legislative activity are ongoing in each of these areas and will be important to watch in 2022.

Liability management transactions were also the subject of important litigation in 2021. In *Trimark*, a New York state court addressed one indicative uptiering transaction, in which a majority group of lenders entered into a debt amendment that granted the borrower necessary relief and new-money financing, while permitting the majority lender group to obtain lien-priority relative to other debtholders. The *Trimark* court dismissed minority lenders' claims for tortious interference against the company's sponsors but found that contractual claims against the borrower and the majority lenders were plausible enough to proceed to the litigation discovery stage. As this will be a developing area of jurisprudence, sponsors, portfolio companies and investors on the lender side should carefully evaluate potential liability management transactions going forward, weighing the upsides against associated litigation risks.

Entering 2022, some signs suggest approaching economic challenges that may increase restructuring activity. With the U.S. inflation rate reaching a nearly 20-year high last November, the Fed has acknowledged that inflation may no longer be "transitory" and is expected to accelerate the end of its bond-buying program into the first quarter of 2022 and, subsequently, to begin increasing interest rates. Simultaneously, the global COVID-19 pandemic continues to stress business operations and supply chains, with overhanging

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uncertainty caused by new variants. Combined, these factors may create headwinds and leave highly leveraged companies vulnerable to a combination of operational challenges and external macroeconomic factors that could restrict availability of capital or covenant amendments. Overall, 2022 appears to be a year in which sponsors should hope for the best, including a substantial economic recovery if COVID-19 recedes, but remain watchful and carefully monitor both the covenants and liquidity of their portfolio companies, as there is a real possibility of tighter credit markets in the year to come.

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False Claims Act Suits: Risks for PE Firms and Their Board Representatives

While healthcare and life science companies have long been targeted by suits brought under the False Claims Act ("FCA"), such suits are now including claims against PE sponsors that have an ownership stake in these companies—even if the PE firm is only a minority shareholder—or sponsor representatives that sit on the company's board. PE firms can take steps to mitigate the risk of such litigation by ensuring a clear demarcation between the roles of the PE firm, board representatives, and the portfolio company itself. If faced with an FCA suit, PE firms should consider adopting a litigation strategy that emphasizes these distinctions.

FCA claims against PE sponsors or their representatives typically have been based on two types of allegations. In some cases, PE defendants are alleged to have participated in the development of a business strategy that involves unlawful conduct or are otherwise responsible for such practices by virtue of imposing unsustainable financial demands on the portfolio company. In others, PE defendants are alleged to be responsible for unlawful conduct because they learned of it in pre-acquisition diligence or through the service of their representatives on the portfolio company's board and failed to take steps to correct or remedy the violations. The allegations are not mutually exclusive, and there may be situations where a PE defendant can be targeted based upon both theories. While no PE defendant has yet been found liable in a litigated decision under such theories, in two recent cases, claims survived motions to dismiss and for summary judgment. These matters were both settled, with the PE firm making a financial contribution to the settlement.

In light of these risks, PE firms should consider whether appropriate compliance and governance practices are in place at investment targets and existing portfolio companies. If a PE firm learns of potential misconduct during the diligence process, it should assess whether and how such issues can be addressed post-acquisition. PE representatives on a portfolio company's board should also encourage the board to be appropriately informed about the company's compliance programs so any potential issues can be proactively identified and addressed. If sponsor-affiliated directors become aware of a significant issue, they should engage with the board and use the board's oversight functions to engage with management, ensure a plan for remediation is in place and consult with counsel where necessary. PE firms can also mitigate litigation risk by being attuned to proper governance protocols and training their representatives on how to navigate their simultaneous fiduciary obligations to the sponsor and to the portfolio companies on whose boards they serve as directors.

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If a PE firm or its representative is sued under the FCA, its defense strategy should include not only a response on the merits but also (where appropriate) an explanation of PE firm corporate governance. In some cases, FCA plaintiffs have sought to target PE's "deep pockets" by blurring the roles that may have been played by the portfolio company, the PE firm's representatives on the portfolio company's board and the PE firm itself (typically to support the allegation that the PE firm controls the day-to-day operations of the company). Distinguishing between the separate roles and duties of each party may be critical to rebuffing any attempt to hold a PE firm or its board representatives responsible for the alleged conduct of the portfolio company.

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Private equity activity in the insurance sector (particularly, but by no means exclusively, investments in and acquisitions of life and annuity companies) was very strong in 2021, as sponsors invested in or acquired insurance companies and provided them with investment management services under long-term agreements. These transactions appeal to insurance companies as they seek capital for growth and for investment in new technologies, as well as the possibility of higher yield on their asset portfolios without increasing—and ideally decreasing—volatility in those portfolios. The transactions are appealing to PE firms as the insurance industry is in flux, and there is a demand for long-term private equity capital, as well as an attractive opportunity to deploy assets into longer-dated credit strategies. (We discuss the relationship between PE firms and insurance companies in detail here.)

State Insurance Regulatory Environment

U.S. state insurance regulators have an important role in overseeing acquisitions of control (or of a controlling interest) in insurance companies, and any transactions between insurance companies and their affiliates. The individual state insurance regulators coordinate their efforts through the National Association of Insurance Commissioners ("NAIC"), a regulatory industry association that promulgates rules to be formally adopted, administered and enforced by the states.

On September 30, 2021, the NAIC Financial Stability (E) Task Force received a report regarding private equity activity in the insurance industry and discussed ways to address regulators' questions and considerations regarding transactions involving PE firms. The Task Force met again on December 7, 2021, and heard an update from the NAIC Macroprudential (E) Working Group, which the Task Force affirmed as the NAIC's coordinating body regarding regulatory activity related to private equity owners of insurers.

The Task Force exposed draft Regulatory Considerations (available here) for comment. While these considerations are not exclusive to private equity transactions

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nor necessarily relevant to a particular private equity transaction, they are a useful indicator of regulatory concerns regarding private equity involvement in the insurance industry. The considerations listed include the following:

- insufficient transparency to regulators of risk due to holding company contracts and affiliated or related party agreements being structured to avoid regulatory disclosures and approval requirements;
- control via means other than 10 percent or more voting security ownership, such as board seats and management representation, and contract rights, including non-customary minority shareholder rights or covenants;
- investment management agreements, including whether they are arm's length, the amount of investment management fees (with excessive fees to a related party suspect as essentially unauthorized dividends), onerous or costly obstacles to termination, or excessive control or discretion given to the investment manager over investment strategy and its implementation;
- misalignment of investment interests of owners, including owners focusing on short-term results and unwilling to transfer needed capital into a troubled insurer;
- operational, governance and market conduct practices of an insurer being impacted by the different priorities and level of insurance experience possessed by first-time entrants into the insurance market relying on third-party administrators, which may lead to adverse results for policyholders;
- the need to better identify investments originated by related parties (including structured securities such as collateralized loan obligations that may lead to exposure to private equity portfolio companies) that may create potential conflicts of interest and excessive or hidden fees in the portfolio structure;
- the need for enhanced insurer investment and collateral reporting, including categorization of investments (such as qualifying bonds and asset-backed securities);
- material increases in insurer investments in privately structured securities (either by affiliated and non-affiliated asset managers), thus increasing credit risk and introducing other risks, such as complexity risk and illiquidity risk;
- reliance on rating agency ratings and their appropriateness for regulatory purposes;
- life insurers engaging in pension risk transfer ("PRT") business and such business being supported by the more complex (and often private equity-related) assets if they do not perform as the company expects, and the need for stress testing and best practices for valuation of nonpublicly traded assets and to consider risk-based capital treatment for PRT business; and

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- insurers' use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency that introduce complexities into the group structure.

Implications of the NAIC Considerations

Many of the considerations identified by the Task Force are not new. For example, between 2013 and 2015, the New York Department of Financial Services and the NAIC focused on the acquisition of life and annuity businesses by PE firms, which led to states enhancing their analyses of private equity M&A (see, for example, NY Insurance Regulation 52), and imposing requests for certain conditions or commitments from PE investors during the Form A review process.

More recently—including in the Regulatory Considerations discussed above—insurance regulators have been emphasizing that they believe they do not have sufficient oversight of transactions between private equity firms and insurers. States' insurance holding company acts and regulations (which are substantially similar to the NAIC models) have always provided approval and notification rights regarding controlling and affiliated parties based on "control," which is generally presumed at direct or indirect ownership of 10 percent or more of the voting securities of an insurer, although control also can be found in other ways and based on a combination of factors (indicia of control), including by contract or otherwise.

Moreover, last year the NAIC amended statutory accounting principles and the insurer annual statement form to add details of transactions based on an expanded definition of "related parties," including those parties that have disclaimed control or affiliation. Additionally, to address regulator concerns, there is now enhanced reporting to identify assets backing PRT liabilities.

Although it is premature to assess the practical impact of the Task Force's deliberations on state insurance regulation and transactions between insurance companies and private equity sponsors, it is clear that they reflect ongoing concerns among state regulators that the influx of PE capital into the insurance sector may be introducing new risks that regulators are not well prepared to evaluate. In fact, though, the current system does seem already to provide very significant regulatory oversight tools, which have been enhanced recently to focus specifically on PE investors. These tools include the Form A process through which regulators evaluate any acquisition of control, and in which regulators have customarily sought to impose enhanced reporting and other restrictions on PE investors when deemed appropriate.

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As private equity continues to become a larger presence in the insurance sector, we believe it to be critical that regulators and private equity sponsors maintain an open and transparent dialogue regarding all aspects of these investments. Regulators have an appropriately broad mandate to make sure they understand the risks in their regulated entities; PE sponsors can bring significant benefits that bolster the safety and solvency of insurance companies by increasing investment yields and de-risking portfolios.

Conclusion

We believe that, in time, an appropriate balance will be struck between the evolving concerns and considerations of regulators and the interests of PE sponsors investing in the insurance sector. For the time being, while we have seen regulators impose restrictions and engage in intensive review processes that sometimes include "curve ball" type requirements, we also believe that PE sponsors have been able to address all these concerns and successfully execute a number of large and important transactions. PE firms that are successful in the insurance sector understand intuitively the need to treat as paramount the safety and solvency of the insurance businesses, and the honoring of the promises made to their policyholders. That focus, ultimately, will go a long way to assuaging regulatory concerns about the growing role of PE in the insurance industry.

Our involvement in many of the leading PE investments in the industry provides us with broad prospective on this dialogue, and we look forward to being a constructive contributor as the discussions continue and the regulatory framework evolves.

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For private equity firms eyeing foreign investments in sectors and countries with a risk of adverse regulatory change, 2021 saw two notable trends: increasing disputes in the renewable energy sector driven by rollbacks of regulatory incentives, and weakened protection for certain foreign investments under EU law. These developments pose both risks and opportunities for investors in emerging sectors—especially renewable energy—and highlight the importance of maximizing international protections when structuring investments.

In recent years, aggrieved investors have brought a slew of investment treaty claims against EU countries such as Spain and Italy for the rollback of investment incentives in the renewable energy sector. For example, as of October 2020, at least 19 awards totaling more than $1 billion have reportedly been issued against Spain. As we reported here, policy shifts affecting the renewable energy sector are likely to continue following the United Nations Climate Change Conference of the Parties in November 2021, where more than 100 countries committed to transition to a net-zero future.

For investments in sectors such as renewable energy that are vulnerable to such shifts, international investment treaties may provide crucial protection. For example, investment treaties often require the host State to treat foreign investments fairly and equitably, and arbitration clauses in those treaties provide investors with a neutral international forum in which to seek relief when suing the host State in its own courts is not a viable option.

Access to treaty protection, however, depends on various factors. As we discuss here, the upstream fund structure can make or break an arbitration claim, because treaty protections vary depending on the investor's nationality, ownership and control of the investment. Respondent States have challenged—with varying degrees of success—arbitral tribunals' ability to hear claims by funds and other financial investors based on the fact-specific control rights, trust structures and beneficial ownership of the relevant investment. In addition, some States have challenged whether portfolio investments and certain kinds of financial instruments are protected investments under particular treaties. For example, as we reported here, the Kingdom of Spain argued in *Portigon v. Spain* that the long-term loans and interest rate swaps issued by a financial services firm for the development of a renewable energy project were not protected investments under the multilateral Energy Charter Treaty and the ICSID Convention. While a majority of the tribunal disagreed and sided with Portigon, the German firm that issued the debt, the question of whether investment treaties cover certain types of investments remains an evolving area of jurisprudence and needs to be carefully monitored.

Meanwhile, the future of investment protection in the EU is under fire after the Court of Justice of the European Union, the EU's highest court, continued its policy of refusing to recognize arbitration agreements between EU investors and EU Member States, including under the Energy Charter Treaty and case-specific agreements between the investor and the host State. As we reported here, however, arbitral tribunals have continued to accept the validity of these agreements and to hear intra-EU cross-border investment disputes, and investors have had some success enforcing these awards outside the EU. Nonetheless, the continuing uncertainty around cross-border investment protection in the EU has prompted an active secondary market of existing claims and awards, offering long-term investment opportunities. Even so, investment protection in the EU will remain in flux, and prudent investors will likely look to investment structuring and contractual protections.

In sum, these developments illustrate that a coordinated and discerning investment structuring strategy can be vital to protecting private equity investments.

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