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From the Editors

The year 2023 is now squarely in the rear-view mirror, with the private equity industry leaving behind it a year marked by high interest rates, challenging conditions in both fundraising and financing, and a muted M&A market around the globe. In this difficult environment, the industry found opportunity where it could with creative deal structures that limited the need to access the debt markets, bespoke financing solutions from an expanding pool of alternative capital providers and a rapidly evolving private funds transactions arena.

While by all accounts the industry has adjusted to this new normal, there are signs that the clouds are parting. Interest rates have peaked, inflation has receded, the "soft landing" seems to have been achieved, and there is increasing expectation that 2024 will see more robust M&A markets.

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"I just started a rumor that I'm dating Taylor Swift."

Celebrating 20 Years The Private Equity Report

What's Inside

If there is guarded optimism on the macroeconomic front, however, regulations continue to generate new hurdles. The SEC's new Private Fund Adviser Rules introduce a regime that goes beyond anything contemplated since the 1940 Advisers Act, while the agency is taking a stringent approach to enforcing the Marketing Rule. New rules on everything from ESG to predictive data analytics are in the pipeline. In both the United States and the European Union, regulators are focusing more and more attention—if not outright hostility—on mergers, while in the U.S., noncompete agreements have come under sustained legislative attack.

The 2024 Private Equity Outlook summarizes how these developments—both favorable and less so—have unfolded to set the stage for the year ahead. We hope that you will find this to be a useful guide as you chart a course through this varied landscape.

This report is a publication of **Debevoise & Plimpton LLP**

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After a decade of remarkable growth, 2023 saw a significant slowdown in fundraising activity. With investors looking to trim allocations as a result of the denominator effect and a lack of liquidity across their portfolios, sponsors across industries and geographies faced a very competitive fundraising environment.

Interestingly, middle-market sponsors generally fared better than mega-funds in this challenging fundraising environment. While a number of mega-funds saw successful final closings over the course of 2023, middle-market funds accounted for a majority of capital fundraising for the first time in several years as investors were drawn to their more focused strategies and relatively strong returns. Private credit funds also represented a larger than usual share of capital raised in 2023 as a result of the continued high-interest rate environment. On the other hand, venture capital fundraising saw a notable decline over the course of 2023 as tech markets remained under considerable stress.

Due to these market conditions, prolonged fundraising periods were routine and sponsors offered economic incentives and other accommodations to investors that were less common in recent years. Institutional investors also expressed an increased desire for separately managed accounts and other co-investment arrangements in an effort to reduce the cost of their overall investment programs with sponsors. To unlock further capital, sponsors have continued to engage with a broader investor base (including a notable focus on retail investors), expand into new geographies and explore novel fund structures. Sponsors have also continued to utilize the secondary market and continuation funds to provide liquidity to their investors while still retaining control of portfolio companies that they believe have further value-creation potential. We expect these trends to continue into 2024.

In the midst of this fundraising slowdown, sponsors were also required to spend a significant amount of time and attention on a slew of complex and burdensome new laws and regulatory proposals affecting the private funds industry. In particular, the SEC's new Marketing Rule and private fund adviser rules have introduced significant cost and complexity for sponsors in both fundraising and managing their products. Sponsors continue to look for ways to develop effective tools and procedures to address these new rules and other proposed or recently enacted legislation.

While the global economic environment remains uncertain, we continue to be optimistic that the environment will improve in the coming year. It is anticipated that M&A deal activity will pick up in 2024, which would lead to more exit opportunities and therefore more liquidity for limited partners to invest. With a number of sponsors looking to launch fundraises in 2024, we expect a more favorable fundraising environment in the year to come, especially for sponsors who have been successful in maintaining strong relationships with their limited partners.

Fund Finance

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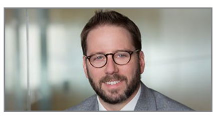

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The year 2023 proved to be quite a remarkable one for the fund finance market. While fund sponsor demand for debt financing continued its strong growth through 2023, traditional lenders continued to be constrained by their balance sheets, making way for alternative lending sources and innovative financing products and structures to fill liquidity gaps of fund sponsors. We expect this general trend to continue through 2024.

The collapse of Silicon Valley Bank, Signature Bank, First Republic Bank and Credit Suisse created a moment of panic across the fund finance industry in early 2023. Affected fund borrowers scrambled for alternative liquidity sources, and the broader fund finance market wrestled with the knock-on effects of these bank failures. At the same time, other key commercial bank lenders in the fund finance space continued to be affected by interest rates increases, regulatory changes in capital treatment and other macroeconomic events, which drove balance sheet constraints and forced traditional lenders to be much more selective about credit extensions to fund sponsors. We also observed an increased focus on syndication efforts, through both assignment and participation, in an effort to relieve balance sheet stress. These factors resulted in greater competition for the limited bank balance sheet capacity available to the fund finance market.

The resulting deficiency of debt capital for funds continues to create substantial demand for alternative liquidity providers and bespoke financing solutions in the fund finance market. With this demand, of course, comes opportunity, and throughout 2023 we observed considerable expansion of the fund finance lender base, as well as a remarkable evolution of fund finance product offerings. That momentum has continued into 2024.

Subscription facilities remain a staple for many fund sponsors, and demand for capital call-backed credit continues to grow year on year. We've seen the most growth in the NAV space, where the use of asset-based leverage has extended beyond credit and secondaries funds into various levels of the capital structure and across a broader range of funds. With the leveraged finance markets disrupted, sponsors are increasingly turning to these products to consummate acquisitions, purchase portfolio company debt and make distributions to limited partners in view of delayed exits from portfolio companies. Conditionality terms for these NAV structures also continue to evolve, with some lenders willing to consider providing these facilities with limited conditions similar to those for opco-level facilities. We also saw alternative fund finance credit providers more willing to offer these bespoke NAV facilities.

Sponsors also continue to raise capital from insurance companies and similar investors. While 2023 had seen a slowdown in activity in the face of market conditions and uncertainty over regulatory developments, we expect rated feeder structures and other structured products, such as collateralized fund obligations, to continue to evolve and develop.

If history is any guide, innovation in the fund finance market will continue so long as sponsors have unmet liquidity needs.

Private Fund Transactions

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On the surface, the 2023 numbers for secondaries, co-investments and other private fund transactions are roughly what they were for 2022 (if not a little higher, due to a year-end rush of LP-led secondaries). Those numbers, however, don’t capture the substantial evolution underway in the industry—and the opportunities that evolution brings.

The initial *raison d'etre* for continuation vehicles was to scrape forlorn assets off of the zombie buyout fund portfolio, a practice reserved for the broken toys department that was out of view for most market participants. Over the past year, however, we have continued to see new entrants adopt these once-niche insular exit strategies for the first time. The limited partner community remains mixed, with some more enthusiastic than others, but the mechanics and flexibility at the core of continuation vehicles have become regular parts of the fund negotiation lexicon. Sponsors are now considering GP-led solutions as an ordinary-course possibility for steadier assets on shorter hold periods and adapting the approach to other sectors, including private credit, real estate, venture capital and infrastructure opportunities. Sponsors have also repurposed longstanding techniques as secondary technology, sometimes turning to preferred equity financing as a more streamlined alternative to infuse liquidity (often with a PIK dividend and equity upside) for secondary providers. Similarly, or sometimes in tandem, private equity sponsors are considering NAV loans supported by the value of the fund portfolio as another less expensive alternative to access cash. As the bid-ask spread begins to narrow and pressure to transact increases on all participants, the private fund transaction industry sits very well positioned to take advantage with a broader base of players, expanded technology and fresh capital raised that is specifically earmarked for secondary deployment.

But if secondaries have influenced the tenor of the larger transaction environment, the reverse is also true: The leverage enjoyed by buyers in the current market, the less frenetic execution timelines and an influx of new buyers with more traditional M&A roots have all hastened the spread of mainstream acquisition practices into the secondaries process. Potential buyers have been able to engage sellers in a more extensive diligence exercise on single-asset continuations; asset-level representations have been shifting away from bare minimum and added some granularity. Representation and warranty insurance policies (or warranty and indemnity insurance) continue to settle as part of standard protocol as more underwriters have determined the space too big to ignore and have tailored policies to meet market demand.

As GP-led transactions have become more common, they have also attracted attention from regulators and industry groups. In May, the Institutional Limited Partners Association ("ILPA") refreshed earlier guidance to take a harder stand on the increasingly common “rubber stamp” waiver mechanics being etched into fund governing documents at the outset that make it possible for certain conflicts procedures to be circumvented wholesale. More than anything, the new guidance underscores the impracticality of imposing one-size-fits-all guardrails given the rapid escalation and variability of deal types and structures.

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Private Fund Transactions

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The ILPA refresh was a precursor to the much-discussed final Private Fund Adviser rules adopted in mid-August by the SEC. Although those new rules were the main regulatory event for 2023, they weren't the only regulatory development affecting the secondaries world last year. At the start of 2023, regulations finalized at the end of 2020 under Section 1446(f) of the Internal Revenue Code of 1986, as amended, took effect, imposing withholding and reporting requirements on the transfers of partnership interests (e.g., interests in private funds) held by non-US persons and imposing secondary liability on the fund itself if the transferee doesn't withhold or obtain certification in lieu of withholding. In light of these regulations, sponsors have become more open to issuing certificates for transfers, and corresponding documentation now often includes representations on withholding (if the forms did not account for already).

It's less clear, however, how the SEC's new Rules will change market practices regarding secondaries. Like the ILPA update, the first reaction from the secondaries industry may have been a collective sigh of relief, as the lasting legacy of the Rules may ultimately be the further institutionalization of secondaries' role in the market. Consider that the scope of "adviser-led" transactions addressed in the Rules mirrors that of the amendments made by the SEC to Form PF back in June, which added a new section for required reporting of "adviser-led" secondaries and which narrowed "adviser-led" secondaries by carving out tender offers or exits with "status quo" options for existing fund investors from the category. Further, the new Rules only address "adviser-led" secondaries once, requiring advisers to obtain fairness or valuation opinions from an independent provider in connection with the above-mentioned narrower subset of GP-led deals and to disclose any material relationships between the adviser and the opinion provider—a practice (at least with respect to the former) that is fairly common.

The rest of the Rules do not let secondaries off the hook entirely. One of the central tenets of the final Rules is to limit or add transparency to "preferential treatment," including disparate information flow and bearing of fees and expenses among certain investor constituencies. Even here, though, the practical effects may be limited. Although the marketing of secondaries opportunities can lead to information being shared with certain existing investors sooner (and the possibility of other uneven terms), the transactions are generally not consummated before information is also shared with the full LP base, albeit not necessarily with the same scope or access.

However, the Rules may not line up as neatly with co-investment processes, where enhanced information is more systemic. The outreach to potential co-investors typically includes information that practically can't be shared with the full LP base but which is necessary for potential co-investors to evaluate further participation. (Moreover, those that do continue their participation also often request that this higher level of information continue going forward.) Of course, the number of co-investors that get to that point may thin out considerably if co-investors are required to bear a share of expenses related to a potential investment that ultimately falls through. Whether that's a realistic possibility or if many co-invest vehicles will be viewed as out of scope cannot

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Private Fund Transactions

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be clearly gleaned from the guidance, given that the safe harbor solutions the Rules provide do not line up with current market practice, nor have negotiations or processes in the immediate aftermath changed to indicate any market consensus.

Even though co-investments emerged as a focal point of the final Rules package, activity has hardly ground to a halt since the Rules' release. Although the denominator effect and the general economic uncertainty have slowed down co-invest allocation for some, many other market participants have significantly ramped up their co-investment activity during this same period, with a substantial minimum co-invest allocation now being a prerequisite for some LPs to make a primary fund commitment.

While co-investments were initially often used as a perk to lure, placate and retain fund investors, sponsors are now reimagining co-investment structures as a much-needed salve to secure additional liquidity for portfolio deals in limbo. In a challenging fundraising and debt financing environment, and with scarce exit options, the capital certainty of seasoned co-investors has been welcomed not only for the traditional, narrower opportunity set of initial side-by-side slices but for funding opportunities across the deal lifecycle and capital stack. For example, we have seen co-invest cash being used to facilitate accretive bolt-on acquisitions or partial liquidity returns to fund investors without sacrificing control or existing debt packages.

As with secondaries, the increased utility and demand for co-invest capital has shifted the market at least somewhat towards the buyer. This shift has changed the tenor of negotiations, with the traditional "take-it-or-leave-it" GP stance on terms giving way to a back-and-forth regarding more information, an enhanced role and more expansive follow-on rights in play.

In some sense, private fund transactions are having a moment, both as a zeitgeisty tool for financial institutions and a cause célèbre for regulators. Yet, up until now, the substantial complexities around these transactions have acted as barriers to entry for many potential participants. As different sectors and industries converge upon these opportunities, new complexities will emerge as veteran participants and new entrants reconcile their own differing schools of practice with developing regulatory guidance and scrutiny of investor alignment. The legal technology has proven to be a stabilizing infrastructure threaded through the development of the industry but also susceptible to anachronism if it is not constantly being to meet the deal that comes next.

Leveraged Finance

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The close of 2023 marked the end of a year of both highs and lows for the financing markets. Activity early in the year was soft, as markets and investors dealt with several successive hiccups, while the second half of the year brought optimism as an increasing number of deals went to market.

In the first half of the year, banks largely remained on the sidelines for new commitments, in part due to regulatory considerations, an uncertain economic climate and lingering capital constraints resulting from the remnants of the LBO over-hang on balance sheets from 2022. In addition, first-half market conditions continued to be plagued by uncertainty resulting from several factors, each causing investors to hesitate deploying capital until the factor eased. On the geopolitical front, the war in Ukraine was grinding into its second year. The Fed's four successive 25 bps rate hikes to 5.50% by July 2023 made investors wary of deploying capital until rate hikes settled, their impact was known and the inflation picture became more certain. The spring's banking crisis affected consumer confidence with many banks for an extended period. Finally, the U.S. government's unsteadiness confronting the debt-ceiling crisis and potential U.S. debt default provided another disruption for investors to wait out.

As a result of these market conditions, sponsors that remained active in early 2023 relied on creative deal structures in order to make investments while limiting the need to access the debt markets. One common strategy was to acquire companies whose financing agreements allowed for portability. In a few cases, the financing agreements expressly contained portability provisions. However, most agreements lacked such explicit provisions, requiring thoughtful structuring so that portability could occur. A common variation of this approach was to acquire only a portion of a business alongside existing equity holders, taking care to set the percentage of the target company acquired by the new sponsor below the threshold that would trigger a change of control provision. In either case, the company would be able to maintain its existing financing arrangements, with interest rates and terms that were likely more attractive than could be obtained in a then-market refinancing.

In the second half of 2023, market conditions improved considerably. Large investment banks were able to access markets to de-risk their balance sheets—including syndicated debt for Cloud Software Group (formerly Citrix and Tibco Software) in April 2023 and Tenneco in August 2023—which allowed banks to be more active in providing commitments for new transactions. In addition, the Fed signaled willingness to halt further rate hikes after the July 2023 increase, thus providing more certainty to both borrowers and lenders regarding market interest rates going forward. Positive investor sentiment gained momentum through Q3 2023, with market activity reaching levels not seen since Q4 2021 and Q1 2022. Deals included opportunistic transactions (which totaled $143 billion in the loan market in Q3 2023, according to LCD) as well as repricings, amend-and-extends and refinancings.

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Leveraged Finance

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The beginning of 2024 appears to continue the trend of more active debt markets, with many refinancings, incremental debt issuances and dividend recaps going to market in the first few weeks of the year. For companies that are performing well, this trend will likely continue in early 2024, as these entities take advantage of improved market conditions to raise additional financing to fund M&A or dividends or to refinance existing debt. Meanwhile, the frequency of liability management transactions may remain elevated in early 2024, as companies performing less well and with near-term maturities may struggle to refinance their substantial leverage due to the increased capital costs from higher interest rates. With 2024's U.S. presidential and congressional elections providing the potential for uncertain macroeconomic factors in the second half of the year, investors may seek to be more opportunistic while conditions are more stable.

M&A (U.S.)

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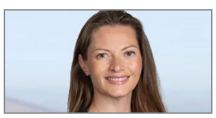

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The second half of 2023 saw a continuation of the lull in private equity deal-making from the first half of the year, albeit with signs of green shoots as the calendar approached 2024.

Although debt financing was more readily available in 2023 than when the deal market initially slowed in 2022, it was relatively expensive, putting private equity buyers in a challenging position given the need to meet seller pricing expectations while modeling sufficient returns on equity. Given this relatively slender needle to thread, we saw a greater number of potential transactions fall apart before getting to a signing.

As was the case in the first half of the year, sponsors continued to get creative in order to deploy capital (for example, with continuation fund transactions or minority investments) and dry powder continued to accumulate, notwithstanding a bit of a slowdown in the fundraising environment.

We saw a marked increase in deal activity in December; might this preview a return to robust deal volumes in 2024? It certainly seems plausible, given that interest rates appear to have peaked, and sellers continue to hold assets that, in a different environment, they might have parted with in 2022 or 2023.

What else do we expect to see in 2024? Given current deal instability, there will likely be a renewed emphasis on deal certainty by both buyers and sellers, with both parties keeping a careful eye on antitrust concerns and on how government policy regarding the M&A industry might be affected by the presidential election year. That said, competition for quality assets has remained fierce even in the recent slowdown, so in a world of decreasing rates and plenty of capital, we would not be surprised to see an uptick in buyers trying to preempt processes, meaning they will need to move quickly to get comfortable with these issues and their due diligence.

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Private equity M&A in Europe remained subdued in 2023. Nevertheless, as the end of the year approached, there were signs that activity may pick up in 2024, particularly in the middle market.

Towards the end of 2023, we saw early indications that leveraged buyout activity levels were recovering in Europe. In the first three quarters of 2023, there were only 28 deals in Europe valued at more than €1 billion, representing the lowest volume of such deals in a decade. Despite this, 57% of cumulative deal value during the same period came from deals valued between €100 million and €500 million—the highest percentage in this value range on record. Further, the average deal value in this bracket increased dramatically, from €124 million in Q1 2023 to €290 million in Q3 2023.

These trends are unsurprising and are likely to continue in 2024 as higher interest rates make it more difficult to execute large buyouts. Instead, sponsors increasingly turn to add-on acquisitions to generate growth by buying out competitors or complementary businesses. To finance these deals, sponsors are looking to private credit, which, although often more expensive than traditional bank lending, is generally faster to execute. Mike Arougheti, co-founder of Ares, sees the global private credit market doubling within the next five years.

The market for public listings picked up in 2023, having been very muted during 2022. Public listings accounted for 20% of total European exit value from Q1 to Q3 2023. One standout was the Arm IPO, which generated an exit value of €43.9 billion.

Despite these welcome developments, true third-party purchasers largely remain on the sidelines, forcing sponsors to continue to be creative in their search for exit/liquidity options. Partial exits, whereby an incoming sponsor takes a controlling stake in the target company, have become increasingly common, with almost half of the 20 largest exits in Q3 2023 structured in this way. This exit strategy may be attractive for a number of reasons, including asset maturity, generating liquidity while retaining some future upside, bridging valuation gaps and satisfying any holding period requirements. The market for GP-led secondary transactions also remains strong. We expect these trends to continue in 2024.

In addition to these overarching trends, there are several developments of particular note for sponsors: M&A in the asset management industry; an increased inclination of antitrust regulators globally to view M&A activity with scepticism; and growing scrutiny of foreign subsidies and of foreign inbound and outbound investment.

Asset Management M&A

Dealmaking in the asset management sector continues to accelerate, with cumulative deal value increasing 244% from Q3 2022 to Q3 2023. Negative public market conditions and investors being required to reduce their allocations to asset managers have decreased the value of asset managers' assets under management, leading to reduced management

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M&A (Europe)

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fees. Asset managers have responded by acquiring competitors in order to increase their AUM. Further deal-drivers include the benefits associated with market consolidation, enhancing scale to spread the costs of increasing regulatory burdens, the need to acquire new technologies (in particular, AI) and the desire for product and geographic diversification, as well as buy-side and sell-side commercial considerations. (We discuss in greater detail the factors behind increased M&A in the asset management sector here.)

Merger Control

Looking ahead to 2024, we expect merger control to remain a critical consideration for dealmakers as the various European competition authorities continue to be creative in finding ways to review deals of interest, and the European Union and national Member States expand their toolkit of legislative measures. Roll-up transactions—whereby a PE sponsor or its portfolio companies gain scale through making multiple acquisitions of small targets in the same sector—have been a frequent focus of regulatory scrutiny. In the United Kingdom, for example, we have seen this most actively in the dental and veterinary industries. Going forward, we expect regulators will continue to scrutinize roll-ups by private equity companies across consumer-facing sectors.

New Foreign Subsidies Legislation

As anticipated in our previous update, the EU Foreign Subsidies Regulation (the "FSR") came into full force on October 12, 2023. The FSR, which aims to stop foreign subsidies from distorting the EU single market, introduces a new notification regime when acquiring control of a company or participating in a public tender in the European Union. Under the FSR, the European Commission requires notification of foreign financial contributions above certain thresholds that are received from non-EU countries. The notification regime is mandatory and suspensory—i.e., clearance is required before a deal can be closed.

Foreign Direct Investment ("FDI") Scrutiny

Scrutiny of deals involving foreign investors is also now at unprecedented levels, with a number of European jurisdictions implementing regimes designed to catch minority investments that are below traditional control thresholds. Regulators are also increasingly examining the investor composition of LPs when reviewing foreign investments, with even passive investments coming under scrutiny, depending on the identity and nationality of the investor. This can have a knock-on effect on deal timing.

In the United Kingdom, the government is considering certain changes to the National Security and Investment Act (the "NSIA") to make it "as pro-business and pro-investment as possible," with the public consultation due to end on January 15, 2024. Of particular relevance for PE firms is the proposal to carve out from the regime certain categories of internal restructurings. Under the current rules, restructuring the holding or management of an entity whose activities fall within the mandatory NSIA regime can require notification. While the UK government will be keen to retain review power

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M&A (Europe)

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over "particular reorganizations that warrant scrutiny," it is possible that certain reorganizations may be exempted (for example, in a fund-to-fund transfer where the nationality or ultimate beneficial owner does not change).

Outbound FDI

On January 24, 2024, it is expected that the Commission will outline its plans for a proposed outbound investment regime. While the Commission has so far mooted introducing a so-called "reverse CFIUS" style regime, few substantive details have been released. It is anticipated that the new regime will focus on strategic technologies, such as semiconductors and quantum computing, with the aim of "de-risking" the European Union's economic relationships with countries such as China.

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A few bright spots notwithstanding, overall M&A and private equity activity in the APAC region remained muted in 2023. Dealmakers stayed cautious amidst economic uncertainty, geopolitical tensions and rising interest rates, with the wide gap in pricing expectations of sellers and buyers further dampening activity.

While interest rates remain high globally, as inflation eases there are hopes that rates are close to peaking, if they have not already. A clearer picture on interest rates and greater visibility regarding the economic outlook is likely to provide buyers with more comfort on valuation and may narrow valuation gaps. Further, we expect Asian outbound investments, especially in non-sensitive sectors, to play a more prominent role in the United States and Europe, as buyers there continue to be wary, and sellers—especially those under pressure to exit—become more open-minded about foreign capital.

The **China** market continues to be challenging, as the highly anticipated post-pandemic rebound in early 2023 failed to materialize. That said, depressed conditions provide opportunities for investors with competitive advantage and long-term strategies in China to acquire assets at lower valuations, potentially leading to higher rewards. For example, Chinese online fashion retailer Shein reportedly completed a financing round at a valuation lower than the previous round's valuation, but it is now looking to recover lost ground in a 2024 overseas IPO.

The healthy M&A market in **Japan** has been a welcome outlier from the generally anemic global environment. There are both internal and external reasons for this: Externally, Japan's persistently low interest rates may have whetted investors' appetite for available opportunities. Further, the uptick in Japan's inflation arguably has opened the country to healthier and organic growth in wages and consumption. Internally, Japan's corporate governance reforms and the proliferation of private equity have driven the robust performance of the Japanese M&A market. A notable transaction reflecting these developments can be found in KKR and Global Atlantic's strategic partnership with Japan Post Insurance, where Japan Post Insurance also made a material investment in a reinsurance co-investment vehicle sponsored by Global Atlantic.

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M&A (APAC)

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The slowing market in China and global geopolitical tensions are also drawing investors' attention to **India**, where several initiatives to promote investment are underway, including implementing the final phase of Gujarat International Finance Tec-City (GIFT City), a special economic zone with offshore characteristics and minimal regulatory oversight. Together with the economic reforms under Prime Minister Narendra Modi, including a more liberalized FDI regime and incentive schemes in strategically important sectors such as electronics manufacturing, India continues to benefit from factors such as its young, tech-savvy demographics and accelerating digitalization across sectors.

Despite the hype about the movement of capital from Hong Kong to Singapore, the **Southeast Asia ("SEA")** M&A market remains underdeveloped, with SEA M&A activities continuing to decline since peaking in 2021. That said, there will likely be a surge in deal making in select industries where SEA is strong, including electric vehicles (such as Yorkville Advisors' $1 billion investment in Vietnamese EV maker VinFast following VinFast's prominent U.S. IPO) and technology, media and telecom, such as TikTok's $1.5 billion acquisition of a majority stake in Tokopedia.

With the relatively low-volume deal-making environment, it has also become harder for co-investors to source attractive opportunities to deploy their capital. Even though the down market means less competition from occasional co-investors, competition for allocation among dedicated co-investors such as funds of funds and pension funds remains fierce. As a means of enhancing co-investment deal flow, we are now increasingly seeing co-investors' acquisition of GP stakes, stapled transactions that bundle a primary fund investment and a co-investment, and warehousing transactions where a co-investor fronts the equity check and sells a portion back to the GP later.

M&A (Latin America)

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Private equity investments faced significant challenges in Latin America in 2023 amidst global geopolitical tensions, strict monetary policy and fewer exit opportunities at desired valuations. Among other things, limited access to credit and IPO markets and a number of regional political developments have increased investment uncertainty. While some of these themes are likely to persist in 2024, the road for private equity in the region seems more promising than it did last year.

At a macro level, signs of receding inflation across the largest economies in the region point to a potential reduction in interest rates by local central banks later this year and a re-opening of the region's IPO window. Along with the availability of alternative means of monetization, such as continuation funds and secondaries, this may alleviate pressure from limited partners who have seen their portfolio holdings extended beyond expectations and, additionally, improve fundraising conditions.

From a geopolitical perspective, the implications of the revival of long-term claims by Venezuela over oil-rich territories in Guiana are to be closely watched, as is Argentina's ability to reform its government and implement privatizations. Chile's rejection, for the second time in less than two years, of a new constitution likely ends a period of political

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M&A (Latin America)

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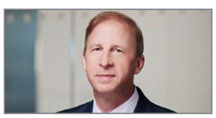
uncertainty there, with recent government announcements indicating a return to investments in core infrastructure alongside the private sector.

In the region's largest economies, nearshoring in Mexico continues to offer the promise of relocating manufacturing facilities and stimulating in-bound foreign investment. In Brazil, the consolidation of regulations covering private equity investment funds ("FIPs"), the approval of long-awaited tax reform and new tax benefits for sovereign wealth funds and private equity infrastructure funds may further the country's agenda in promoting investment opportunities—particularly in the renewables sector, where M&A activity involving foreign investors has continued to attract attention.

On balance, we expect 2024 to continue to favor private sales and alternative monetization structures; we also expect to see a few exits through IPOs. Private equity M&A activity is likely to continue to be driven by investments in untapped consumer markets, industry consolidations and opportunities in the renewables, infrastructure and technology sectors. Assuming improved exit conditions, the demand for private capital will continue to outgrow supply and offer investment opportunities in valuable assets that may be acquired at attractive valuations by both foreign and local private equity sponsors.

U.S. Antitrust



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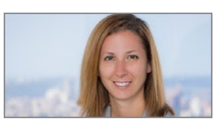

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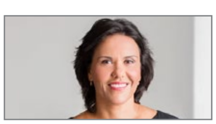

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The year 2023 has been an active one on the antitrust front, both in the United States and Europe. Recent European developments are discussed in the section on European M&A; below, we touch on some of the U.S. developments that are most salient for private equity sponsors.

Changes to U.S. Merger Guidelines

The biggest headline by far is the overhaul by the Department of Justice Antitrust Division and the Federal Trade Commission (the "FTC") of the U.S. merger guidelines. The new guidelines, issued on December 18, 2023, seek to make operational the Biden Administration's tough stance toward mergers.

The guidelines reflect the agencies' attempt to reshape certain antitrust legal standards and deemphasize the economic analysis that has governed antitrust practice over the last several decades. The guidelines significantly lower the bar for when the antitrust agencies believe that a merger is presumptively illegal, including a bright-line rule that seeks to bar mergers that result in a post-merger concentration greater than 30%. Moreover, the guidelines address for the first time topics of particular interest to the Biden Administration, including rollups, labor markets and multisided platforms.

The merger guidelines lack the force of law, but historically have been used by courts as guidance when deciding merger challenges. However, given the new guidelines' drastic departure from historical practice and established case law, the influence of these guidelines on future court rulings remains to be seen.

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Proposed Changes to HSR Form Requirements

On June 27, 2023, the U.S. antitrust agencies released a Notice of Proposed Rulemaking that proposes extensive changes to the filing form used for pre-merger notification under the Hart-Scott-Rodino Act ("HSR"). Of particular note, the proposed changes would require that HSR filings include:

- the identities of directors, officers, board observers, 5%+ minority holders and 10%+ creditors;
- narrative sections on the competitive impact of the transaction, the deal rationale and the timetable;
- information on all acquisitions made by the parties in the past 10 years regardless of size;
- all final and draft versions of documents prepared/received by officer, director or "supervisory deal team lead"; and
- details about the transaction's effect on labor markets.

The agencies are currently reviewing public comments and assessing revisions to their proposals. We expect the final form and instructions will be published in the second quarter of 2024.

The proposed changes would greatly increase the time, burden and expense of HSR filings for all reportable transactions, even those without substantive antitrust issues. The FTC itself estimates the revised form would require three to seven times the current preparation time. Deal timelines would consequently elongate by weeks or months, depending on complexity—underscoring the importance of consulting antitrust attorneys early on in a transaction.

Antitrust Enforcement of Interlocking Directorate Violations

As we discussed in early 2023, the U.S. antitrust agencies have been giving increased attention to the Clayton Act's prohibition against one person holding officer or board director positions at two competing companies. The goal of this prohibition on interlocking directorates is to prevent competitors from exchanging confidential, competitively sensitive information and coordinating business decisions in violation of antitrust laws. The past year saw the agencies continue that sharpened focus, including in the private equity context.

Most recently, in October 2023, the FTC announced a consent order prohibiting private equity firm Quantum Energy Partners from occupying a seat on the board of EQT Corporation. The order was issued in connection with the agency's review of EQT's acquisition of certain natural gas businesses from Quantum, which continued to retain portfolio companies that competed with EQT in the natural gas arena. Quantum received EQT shares as partial consideration for the transaction, which would afford Quantum a seat on EQT's board.

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The consent order contained numerous other stringent measures, including a requirement that Quantum divest the EQT shares; a prohibition on individuals affiliated with Quantum or EQT serving on each others' boards, as officers or in any other management or decision-making capacity; a requirement that a separate joint venture between the parties be unwound; and ongoing monitoring and reporting obligations, including a requirement to seek pre-approval by the FTC prior to certain share purchases, director and officer appointments, and transactions.

Capital Markets

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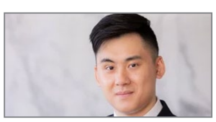

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The U.S. Securities and Exchange Commission (the "SEC") was active in 2023, with several new rules adopted, new guidance released and additional rules proposed. The SEC continues to set an ambitious rulemaking agenda on a variety of topics, and we expect 2024 to bring continued focus on enhancing disclosures by public companies. In addition, the Financial Accounting Standards Board (the "FASB") released a final Accounting Standards Update related to segment reporting in 2023, which we expect to affect the way in which many companies report on their segments.

Adoption of New Cybersecurity Rules for Public Companies

On July 26, 2023, the SEC adopted the long-anticipated final rules on cybersecurity risk management, strategy, governance and incident disclosure for public companies. The rules introduce three new types of disclosure requirements relating to (1) material cybersecurity incidents, (2) cybersecurity risk management processes and (3) cybersecurity governance and oversight. These rules are part of the SEC's larger efforts regarding cybersecurity regulation, resulting in a growing universe of rules aimed at different types of SEC registrants (including registered investment advisers, funds, broker-dealers and other market participants) and increasingly aggressive enforcement.

Registrants are now required to disclose on Form 8-K specified information about material cybersecurity incidents within four business days of determining that a cybersecurity incident they have experienced is material. Registrants will also be required to provide disclosure in their Form 10-K regarding their cybersecurity risk management programs, the board's oversight of cybersecurity threats and management's role in assessing and managing the risks posed by those threats.

Registrants other than smaller reporting companies were required to comply with the material cybersecurity incident disclosure requirements on Form 8-K beginning on December 18, 2023. Smaller reporting companies will have an additional 180 days to begin complying. The cybersecurity risk management processes and cybersecurity management and governance disclosures are required beginning with annual reports on Form 10-K for fiscal years ending on or after December 15, 2023 (i.e., for calendar year companies, the 2023 Form 10-K filed in 2024).

Further Delays to SEC's Final Climate Disclosure Rule

In December 2023, the SEC announced a "Final Action" date of April 2024 for its rule on climate-related disclosures. The SEC originally proposed the rule in March 2022, but

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the release of the finalized rule has been repeatedly delayed. The proposed rule would require all SEC registrants to disclose greenhouse gas emissions and other climate-related information in their SEC filings, as well as to describe various climate-related risks to their business, operations and financial condition. The proposed rule has received thousands of comments since the original proposal, and legal challenges are expected if the final rule is adopted with substantially similar requirements as the proposal.

California Climate-Related Disclosure Requirements

In the meantime, California has enacted its own climate-related disclosure requirements, which in certain respects reach further than those proposed by the SEC. On October 7, 2023, Governor Gavin Newsom signed SB 253, which requires covered companies to disclose their greenhouse gas emissions (including Scope 1, 2 and 3 emissions), and SB 261, which requires covered companies to publish a biennial climate-related financial risk report disclosing climate-related financial risks and measures taken to mitigate and adapt to those risks. Both SB 253 and SB 261 apply to private and public U.S. companies that do business in California and exceed certain revenue thresholds; in contrast, the SEC's proposed climate disclosure rule would apply to SEC registrants only. California also enacted AB 1305, which requires specified disclosures to be made by entities operating in California that market or sell voluntary carbon offsets or that make claims regarding the achievement of net zero emissions, carbon neutral status or significant carbon emissions reductions.

SEC's Share Repurchase Disclosure Rules Vacated

On October 31, 2023, the Fifth Circuit ruled that the SEC violated the Administrative Procedure Act in the rulemaking process for its share repurchase disclosure rules and directed the SEC to "correct the defects" in the rules by November 30, 2023. The Fifth Circuit rejected the SEC's request for a 60-day extension and, after the SEC failed to correct the defects by the November 30 deadline, vacated the final rule on December 19, 2023.

The share repurchase disclosure rules would have required most SEC registrants to disclose their daily share repurchase activity on a quarterly basis. The rules would also have required additional disclosures in registrants' periodic reports regarding (1) the objective and structure of a registrant's repurchase program, including Rule 10b5-1 trading arrangements, (2) policies relating to trading activity by officers and directors during repurchase programs and (3) trading activity by officers and directors in close proximity to an announcement of a share repurchase program. It remains to be seen if the SEC will re-propose the share repurchase disclosure rules in an attempt to "correct the defects" that scuttled the previously adopted rules.

Updated Segment Reporting Disclosure Requirements

On November 27, 2023, the FASB issued a final Accounting Standards Update requiring increased disclosure about public companies' reportable segments. The update will require companies to disclose significant segment expenses that are regularly provided to the chief operating decision maker (CODM) and are included within each reported

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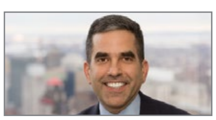
measure of a segment's profit or loss. Companies will also be required to disclose a total amount for "other segment items" not included in significant segment expenses for each reportable segment, as well as a description of the "other segment items" included in each figure. Companies with a single reportable segment will also now be required to provide all segment disclosures.

The update also permits companies to disclose multiple measures of segment profit or loss if the CODM uses more than one measure to allocate resources and assess performance. However, the SEC staff has indicated that if a company reports more than one measure of segment profit or loss, and such measures are non-GAAP measures, they will be subject to Item 10(e) of Regulation S-K.

In addition, if a company has a single reportable segment, the SEC staff has stated that net income will be a required measure of segment profit or loss. This guidance prevents a company with a single reportable segment from reporting a non-GAAP measure as its only measure of segment profit or loss, which would also not be subject to Item 10(e) of Regulation S-K.

The update will be effective for fiscal years beginning after December 15, 2023 and for interim periods within fiscal years beginning after December 15, 2024. Companies will also be required to apply the new disclosure guidance on a retrospective basis, unless it is impracticable to do so.

SEC Enforcement



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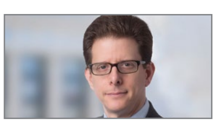

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On November 14, 2023, the U.S. Securities and Exchange Commission's Division of Enforcement announced its enforcement results for fiscal year 2023. The cases brought in FY 2023 against private fund advisers reflect a continued focus on the Commission's long-established priorities, including fee and expense disclosures and conflicts of interest, while the Commission's sweeps underscored its scrutiny of alleged violations of the SEC's Marketing and Custody Rules. Moving into the 2024 fiscal year, we expect that the SEC will continue to prioritize cases in these areas as well as focusing on private fund adviser recordkeeping as part of the Division's industry-wide off-channel communications sweep and reviewing practices covered by the SEC's newly adopted and long-awaited private fund adviser rules. We highlight below a number of notable cases and sweeps from FY 2023 that reflect the SEC's focus on private fund advisers and that serve as a preview of the Division's likely enforcement priorities in FY 2024. We also expect the SEC to continue to pursue an aggressive enforcement agenda, including seeking ever-higher penalties as part of its remedies and testing novel theories of liability.

Calculation of Post-Commitment Management Fees

The SEC has brought a number of cases over the last several years focused on advisers' calculations of post-commitment management fees, alleging that advisers have overcharged client funds. The SEC expanded this focus in FY 2023 by bringing a settled

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SEC Enforcement

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action in May 2023 against investment adviser Sciens Diversified Manager, LLC, alleging that the firm's policies and procedures for calculating post-commitment management fees were not reasonably designed and gave only minimal guidance regarding how to value the investments in accordance with GAAP. In June 2023, the SEC brought a settled action against Insight Venture Management LLC for allegedly charging excess management fees by inaccurately calculating those fees based on aggregated invested capital at the portfolio company level instead of at the individual portfolio investment security level, as required by the fund documents. In addition, the SEC alleged that Insight failed to disclose conflicts associated with its methodology for calculating whether portfolio assets would be considered permanently impaired, finding that the methodology was narrow and difficult to satisfy. Consequently, the SEC alleged that Insight's investors were unaware that its permanent impairment criteria granted the firm significant latitude to determine whether an asset would be considered permanently impaired so as to reduce the basis used to calculate Insight's management fees. These cases underscore that the SEC will not hesitate to carefully scrutinize and challenge advisers' disclosures and policies and procedures around fee calculations.

Custody Rule and Marketing Rule Sweeps

In September 2023, the SEC brought a series of actions against advisers as part of a Custody Rule sweep. Specifically, the SEC announced settled charges against five investment advisers to private funds for violating the Custody Rule by failing to perform audits and deliver audited financial statements to fund investors, failing to maintain assets with qualified custodians and, for two of the firms, failing to promptly update Form ADV when the firms received audited financial statements. The firms agreed to be censured and cease and desist from the violations, as well as to pay penalties collectively totaling $560,000.

As part of another sweep, the SEC brought settled charges in September 2023 against nine registered investment advisers for advertising their performance in a manner that allegedly violated the Marketing Rule. The SEC found that the advisers provided hypothetical performance to a mass audience on their websites without adopting or implementing policies and procedures required by the Marketing Rule. While these cases primarily targeted retail advisory firms, we expect that the Division will continue its focus on potential Marketing Rule violations by scrutinizing private fund advisers' marketing materials, particularly around the presentation of performance.

Looking ahead, we expect to see continued aggressive enforcement investigations involving private fund advisers. SEC Enforcement Director Gurbir Grewal listed private funds as a "substantive priority area" for the Enforcement Division at the Securities Enforcement Forum 2023 conference in October and specifically emphasized that the Division was concerned about perennial risk areas, such as conflicts of interest and fee- and expense-related issues.

U.S. Funds Regulatory

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The Private Fund Adviser Rules

As anticipated, the SEC adopted in August 2023 a much-debated package of private fund rules that reshapes the SEC's regulation of private fund advisers. The new rules, proposed in 2022, add an unprecedented, substantive system of regulation of private fund advisers beyond the scope of anything contemplated by regulators since the adoption of the Advisers Act in 1940.

As we previously discussed, the adopted Private Fund Adviser Rules are slightly more favorable than what was initially proposed, although this is a Pyrrhic victory in most respects. Provisions that survived the public comment process include specific requirements for "restricted activities," conditions when sponsoring "adviser-led secondary" transactions, mandated quarterly investor reporting and restrictions on preferential treatment granted to certain investors. A coalition of industry advocates seeking to invalidate the rules filed a challenge in the Fifth Circuit in September 2023; the case is currently pending. It is unclear whether the outcome of the challenge will affect the compliance dates, currently set for September 2024 and March 2025.

Notwithstanding the legal challenge, most private equity fund sponsors should waste no time in undertaking a gap analysis and risk-mapping exercise to assess the changes in practices and policies that might be necessary in order to come into compliance with the Private Fund Adviser Rules. At a minimum, sponsors should plan to: (i) assess the application of the rules to different fund structures, including funds-of-one, parallel funds and co-investments; (ii) review and, in some cases, modify historically standard rights granted to certain investors that may be implicated by the new preferential rules; (iii) consider new disclosure and modified provisions for limited partnership and fund governing documents; and (iv) modify existing reporting systems and processes.

The Marketing Rule

As discussed in greater detail in this issue's section on SEC Enforcement, the Marketing Rule, which came into force in November 2022, provided the SEC with multiple enforcement and examination opportunities (and several notable settlements) in 2023. We are also aware of a number of ongoing examinations of private fund advisers' Marketing Rule practices, including the calculation of net performance involving subscription facilities and other forms of leverage, treatment of yield as performance and "not meaningful" designations in track records involving new funds. That the SEC staff is engaging on the Marketing Rule through examinations, rather than via interpretive means such as FAQs or no-action positons, signals the agency's particularly stringent expectations regarding compliance.

New Form PF

New requirements to Form PF became effective at the end of 2023 for private equity fund sponsors. They are now required to report quarterly in Section 5 of Form PF the occurrence of any of the following events: (1) the execution of an adviser-led secondary

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U.S. Funds Regulatory

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transaction (as defined in Form PF); (2) the removal of a fund's general partner; and (3) an investor election to terminate a fund or an investment period. The reporting must be made within 60 days of the end of the quarter in which the event took place. Although the compliance date for the quarterly reporting was December 11, 2023, we understand that the SEC staff expects private equity fund sponsors to look back to October 1, 2023 to determine any reportable events for the fourth quarter 2023. This means any reportable event that occurred since October 1, 2023 should be reported on Form PF before March 1, 2024.

Beginning in April 2025, large private equity fund sponsors—those with $2 billion or more in fund assets under management—will be required to provide new information annually in Section 4 of Form PF. That new information includes:

- general partner or limited partner clawbacks;
- fund-level borrowing;
- events of default;
- fund strategy by percentage of deployed capital; and
- bridge financing to controlled portfolio companies.

SEC Rulemaking Agenda

The SEC's recently released Fall 2023 Regulatory Agenda signals that the investment management industry will have no relief from the agency's breakneck rulemaking pace. Relevant proposed rules with a target adoption date of spring 2024 include:

- ESG Rule;
- Cybersecurity Rule;
- Safeguarding Rule (to replace the existing Custody Rule);
- Outsourcing by Investment Advisers; and
- Predictive Data Analytics Rule.

In addition, the Fall Agenda indicates that the following rules will be proposed in the spring of 2024:

- revisions to Regulation D and Form D; and
- Securities Held of Record Rule (potentially amending the "held of record" definition in the rules under the Securities Exchange Act of 1934).

ESG


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ESG has unquestionably remained on the radar of private equity firms in 2023 and is posed to remain so in the new year. We highlight below some recent developments likely to shape firms' ESG priorities in 2024.

United States

New SEC Rules

In 2023, the SEC focused on three climate-related rules. ***First***, the amendment to the "Names Rule" took effect, requiring funds with names that include ESG terminology to make 80% of their investments in such assets.

Second, the "Issuer Rule"—now expected to be finalized in April 2024 after delays in 2023 —would require all SEC registrants, including public companies, to disclose greenhouse gas emissions and other climate-related information in their SEC filings.

Third, the "Funds Rule"—similarly expected to take effect in April 2024 after delays—would require entities in scope to disclose ESG factors considered in fund prospectuses, annual reports and adviser brochures.

Guidance on Carbon Markets

On December 4, 2023, the Commodity Futures Trading Commission released details of proposed guidance regarding the trading of voluntary carbon credit derivative contracts. The guidance outlines considerations regarding relevant rules, terms and conditions, and it encourages transparency, additionality (i.e., that an incentive contributes to carbon removal that would not otherwise have occurred), permanence of carbon removal and robust quantification.

This guidance comes at a critical juncture given the significant growth of the global carbon credit market in recent years. At the same time, countries continue to develop their domestic carbon markets, with more regulation expected in the coming years.

The Political Environment

ESG continues to be a polarized (and polarizing) issue in the United States, affecting entities' ESG-related disclosures and public commitments, among other things. This fall, the House Judiciary Committee issued several subpoenas—including to BlackRock, State Street, Vanguard and the Glasgow Financial Alliance for Net Zero—seeking documents and communications relating to the promotion and adoption of ESG goals. The cover letters to the subpoenas claimed in part that, as members of Climate Action 100+ and other ESG organizations, these entities are colluding to deliver net-zero greenhouse gas emissions by 2050 in breach of U.S. antitrust law.

Additionally, in 2023, more than a dozen U.S. states passed so-called "anti-ESG" legislation, restricting consideration of ESG factors in investment decisions or the exclusion of certain industries, such as mining, fossil fuels and firearms. We anticipate the passage of additional state-level "anti-ESG" laws in 2024.

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ESG

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Europe

On December 14, 2023, the European Council and the European Parliament provisionally agreed to adopt the Corporate Sustainability Due Diligence Directive (the "CSDDD"), which imposes an obligation on companies to identify, mitigate and prevent actual and potential impacts on human rights and the environment. The agreement must be formally adopted by both bodies before it can be enacted. In its current form, the CSDDD does not apply to financial institutions but contains a clause allowing for their possible future inclusion.

Meanwhile, the EU Corporate Sustainability Reporting Directive ("CSRD") takes effect for financial years beginning on or after January 1, 2024 for companies with securities listed on an EU-regulated market. CSRD requires in-scope companies to include extensive sustainability information in their annual reporting, in accordance with the European Sustainability Reporting Standards. (See our In Depth article for an analysis of CSRD's impact on worldwide groups.)

The United Kingdom indicated that it plans to set out formal proposals to regulate the ESG ratings industry in January 2024, with the goal of increasing transparency around methodologies, governance and processes involved in rating investments' ESG credentials.

Globally

In September 2023, the Taskforce on Nature-related Financial Disclosures (the "TNFD") published the final version of its recommended disclosures, together with sector guidance for financial institutions. The TNFD provides a framework for companies to report on how their operations and value chains (broadly, their suppliers, distributors and customers) both impact and depend on nature and biodiversity. (For more details on recent developments, see our Biodiversity 101 guide.)

In June 2023, the International Sustainability Standards Board released its new global sustainability climate and reporting standards. The standards have had a significant global impact, with several governments (including the United Kingdom, Canada, Japan, Singapore and Nigeria) indicating their intention to formally endorse and adopt the standards.

Data Strategy & Security

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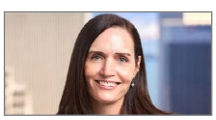

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Top Five Cybersecurity Priorities for PE Firms in 2024

As private equity firms head into 2024, AI and Big Data continue to reshape not just the industry's opportunities but also its cybersecurity risks. Firms should therefore consider these five priorities to stay ahead of the evolving cybersecurity landscape.

1. **Regulatory Compliance:** PE firms will be subject to new cybersecurity regulations in 2024. For example, registered investment advisers (including PE firms) and their affiliated broker-dealers will be subject to new SEC cyber rules. PE firms and portfolio companies that are NYDFS-regulated entities will be subject to the revised Part 500 cyber rules, and both publicly traded PE sponsors and their listed portfolio companies are subject to the new SEC cyber disclosure rules. Those entities should conduct a gap analysis of their compliance with these new rules and create a road map for closing those gaps. It may be most efficient to combine this type of compliance assessment with a comprehensive risk assessment, which is a requirement under several proposed and current cyber regulations.

2. **Update Incident Response Plans:** Many PE firms will need to update their cyber incident response plans to meet these new regulatory requirements. The proposed SEC cybersecurity rules for registered investment advisers and broker-dealers will impose a requirement for 48-hour cybersecurity incident notification to the SEC. Additionally, all public PE firms and portfolio companies should ensure that incident response plans provide for escalation and assessment of incidents that could be considered material under the new SEC Form 8-K requirements. Firms may wish to test incident response plans with a tabletop exercise that measures preparedness for compliance with the new SEC rules.

3. **Vendor Risk Management:** With so many cyber incidents involving a compromise of firm data that is held by third parties, PE firms should review their cyber third-party risk management frameworks, and consider enhancements to their vendor risk management processes, including identification of high-risk vendors, due diligence procedures, contractual representations and obligations, and data minimization protocols for vendors (e.g., giving vendors less sensitive data or requiring vendors to delete sensitive data that they no longer need). The proposed SEC cyber rules for registered investment advisers and broker-dealers will require firms to impose such enhancements and safeguards on third parties.

4. **AI Data Risks:** Because many AI projects involve the movement of large amounts of sensitive data from secure locations to data lakes or cloud environments, information security needs to be integrated into AI initiatives from the start to ensure the security of any sensitive data being used to train or operate models. Similarly, AI projects frequently involve third-party vendors who are given access to large volumes of sensitive information. Cyber diligence on these vendors will be crucial, especially when those vendors are small AI consultants and start-ups.

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Data Strategy & Security

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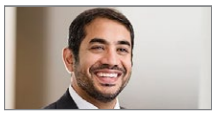
5. **Public Claims about AI and Cyber:** Both the FTC and the SEC have warned firms that they plan to investigate and charge firms and companies that oversell what their AI can accomplish or that claim they are using AI when they are not. Firms should therefore be careful to ensure that their claims about AI use are accurate. Similarly, in light of the SEC's recent cybersecurity enforcement actions, PE firms should confirm the accuracy of their public statements about their cybersecurity controls.

People Solutions



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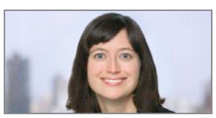

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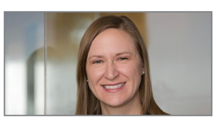

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Recent years have seen a steady stream of statutory and regulatory developments banning or otherwise restricting post-employment noncompetes. We expect that post-employment noncompetes will remain under attack at both the federal and state levels in 2024. Some key developments in 2023 that will continue to evolve in 2024 include the following:

- **At the federal level**, the Federal Trade Commission proposed a sweeping rule in early 2023 that would ban noncompetes for most workers. However, the ultimate scope of any final rulemaking by the FTC on noncompetes remains to be seen, as the FTC is not expected to vote on a final proposed rule until April 2024. Should the FTC adopt the categorical ban on noncompetes as proposed, we anticipate legal challenges to its enforcement on jurisdictional and constitutional grounds.
- The **New York** State Legislature passed a bill broadly prohibiting the use of new post-termination noncompete agreements in the state, which was vetoed by Governor Kathy Hochul on December 22, 2023. Governor Hochul indicated in her veto message to the New York State Senate that she is open to future legislation in this area and supports a ban on noncompete agreements for anyone earning below the median wage in New York.
- In 2023, **California** adopted two new laws that took effect on January 1, 2024 and bolstered its already robust worker-protection statutes against noncompetes. The first new statute, Assembly Bill 1076, requires employers with employees living or working in California to provide individualized written notice to current and former employees who were employed after January 1, 2022 and who are parties to noncompete clauses in employment agreements that these clauses are void. The deadline for this notice is February 14, 2024. The second statute, Senate Bill SB 699, creates a private right of action for employees to challenge noncompete clauses and shifts the employees' attorneys' fees and costs to the employer in the event that the employee prevails in the challenge. The new law also expands the geographical scope of California's protections, meaning the ban applies even if the employment contract was not signed in California, and/or the employment involved occurred outside of the state.
- In a recent string of **Delaware** cases, the state's Court of Chancery applied additional scrutiny to noncompetes, invalidated noncompetes deemed "overbroad" and declined to blue pencil these provisions.

Employers should monitor legal developments at the federal level and in those states where their employees reside and work. Even in instances where noncompetes remain

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People Solutions

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permissible, a more judicious approach is recommended, especially concerning low- and middle-wage workers. Priority should be given to implementing noncompetes with employees who have access to trade secrets, who engage with customers in ways that afford them access to customer "goodwill" or who possess unique skills critical to the organization. Employers should consider a thorough review and update of their restrictive covenants. Such a review should include (1) reviewing the scope and duration of noncompetes to align with the employer's legitimate business interests, (2) revisiting provisions related to confidential information, customer nonsolicitation and trade secret protection and (3) identifying agreements where employee- and state-specific modifications should be made. While narrowly drawn and individually tailored restrictive covenants may seem to provide a more limited scope of protection, they may also bring the benefit of greater enforceability.

Real Estate

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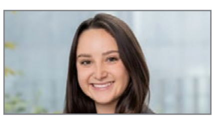

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Looking to 2024, the commercial real estate market continues to face a number of uncertainties. Investors remain concerned about how willingly banks will lend to creditworthy borrowers. Amidst the rising interest rate environment in 2023, traditional lenders tightened standards for commercial mortgages, with some refusing to lend altogether. As a result, many borrowers may have no choice but to consider alternative capital sources such as preferred equity investments and mezzanine loans. These limitations, coupled with higher borrowing costs, may create difficulties for commercial real estate buyers seeking to deploy capital for purchases in 2024.

The office sector continues to struggle, as hybrid and fully remote work arrangements have reduced the demand for space, and developers have slowed new construction efforts. In 2023, office occupancy nationwide plateaued at just under 50% of pre-pandemic levels, with the volume of office sales lagging considerably behind other major property types. While high-quality assets continue to outperform Class B and Class C properties at significant levels as the flight to quality accelerates, occupiers of commercial spaces have nevertheless been hesitant to sign new leases. With nearly $47 billion of office debt maturities looming in the commercial mortgage-backed securities markets in 2024, price discovery is both inevitable and likely fast approaching as borrowers seek to refinance or sell their office properties. Time will tell whether the sector can overcome these challenges as workers slowly trickle back into their offices.

Despite these uncertainties, there are bright spots amidst the gloom that has permeated the real estate space for the past year. Outside the office sector, fundamentals continue to look notably stable. The pandemic has shifted hot spots from office districts to suburban neighborhoods with apartments and retail. Following a near-historic retreat in consumer sentiment in early 2023, the retail sector is now trending upward as a consequence of healthy household spending. Class A and trophy malls have reported high occupancy rates with an increase in luxury retail demand. Owners of shopping centers have benefited from remote work arrangements, as consumers frequent strip malls and grocery-anchored shopping centers more often during the workweek. Trends continue

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Real Estate

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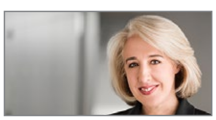
to reflect that retailers with adequate capital will continue favoring higher-quality, upscale locations, while shying away from outdated, poorly located spaces.

Continued growth in e-commerce, fueled in part by strong consumer spending, leads many to believe that industrial real estate will be another top performer in 2024—with rent growth predicted to continue above 7% over the next year. The sustained demand for industrial locations in and around metropolitan areas has resulted in robust competition among tenants for existing space. The sector does continue to face some headwinds, though, as a result of the sharp increases in construction costs. It remains to be seen whether regulatory incentives, such as energy and tax deductions from the Inflation Reduction Act, will sufficiently offset such increased costs.

Heading into 2024, the outlook for real estate appears to be mixed—with pockets of both stability and uneasiness. Market trends existing as of late 2023 indicate that in the new year, investors are expected to focus their attention on niche investments such as data centers and digital infrastructure. There may also be a renewed interest in the life sciences sector following something of a cooling-off period in 2023. In the end, investment opportunities in commercial real estate in 2024 will continue to be heavily influenced by interest rates and the monetary policy of the Federal Reserve.

Restructuring



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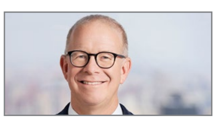

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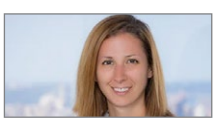

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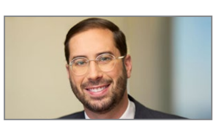

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As noted in the *Debevoise 2023 Private Equity Midyear Outlook*, restructuring activity increased substantially in 2023, and we anticipate this will continue in 2024. At the same time, however—and notwithstanding rising interest rates and the tightening of the money supply—the recession that many were predicting has not come to fruition. As a result, restructuring activity has thus far occurred primarily within certain specific industries and among previously distressed companies for which the current financial environment left little room for flexibility or margin of error.

There are several noteworthy noneconomic developments that may materially affect restructurings in 2024. On December 4, 2023, the U.S. Supreme Court heard arguments in connection with its review of the *Purdue Pharma* Chapter 11 plan, which will determine whether nonconsensual third-party releases are permitted under the Bankruptcy Code in appropriate circumstances. Mass tort bankruptcies almost invariably involve significant claims against non-debtor third parties, making the viability of third-party releases a key issue in those cases because non-debtor parties that are making contributions to the chapter 11 plan generally insist on a global resolution of all potential related claims in exchange for that contribution.

More generally, restructuring matters are receiving more attention in the political arena, with government regulators—and even elected officials—playing a more prominent and active role, particularly in cases involving environmental issues, personal injury or allegations of fraud. Cross-border cases often bring their own political considerations involving comity and the respect to be given to foreign court rulings, as can be seen in

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Restructuring

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the dynamics looming over the efforts to collect on debt owed by Venezuela's state-owned energy company, PDVSA.

Relatedly, industries that are heavily dependent on government funding face their own concerns, including ramifications from changes in the political landscape such as a government shutdown or an unwillingness to assist specific industries or companies in times of crises (such as the wildfire that led to claims asserted against Hawaiian Electric). As we saw during the pandemic, countries and industries are affected by the wide disparity in governments' willingness and ability to assist in the face of external and unexpected disruptions.

Venue is another issue that is likely to command attention. In 2023, the District of New Jersey emerged as a popular venue for large, complex chapter 11 cases. The sudden resignation of a prominent bankruptcy judge in the Southern District of Texas amidst an ethics investigation has once again cast the spotlight on bankruptcy venue considerations and may renew legislative efforts to limit a debtor's flexibility in selecting a venue. Currently, a debtor is provided wide latitude in selecting the venue in which to file its bankruptcy case. Selecting a venue that gives the debtor its best chance for a successful restructuring is frequently an effective tool to drive creditors toward a consensus.

Liability management transactions have proliferated despite the various litigations brought to challenge them, and they are likely to continue in 2024. In addition, companies have recently been entering into "double-dip financing," designed to provide lenders with multiple independent sources of recovery within the borrower's organizational structure—a significant advantage over trade creditors or existing lenders. That said, many companies that have undergone liability management transactions have subsequently filed for bankruptcy, demonstrating that while such transactions can provide critical short-term liquidity and additional runway, they cannot always take the place of a more comprehensive restructuring.

Finally, with the rapid rise in interest rates and the popularity of remote work post-COVID, commercial real estate is an industry that is ripe for restructuring activity. Notably, however—with the exception of the recent bankruptcy filing by WeWork—we have yet to see the large influx of real estate filings or foreclosures that had been anticipated, perhaps in part due to lenders' reluctance to foreclose on collateral in the current environment.

International Disputes/ Business and Human Rights

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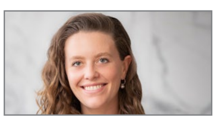

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In 2023, the Organization for Economic Cooperation and Development (the "OECD") revised its Guidelines for Multinational Enterprises on Responsible Business Conduct. Introduced in 1976, the Guidelines are nonbinding recommendations by OECD Member States to multinational businesses headquartered or operating in their territories. Although they are nonbinding, the Guidelines have been highly influential in shaping global business standards and are aligned with several pieces of binding legislation, including the 2022 EU Corporate Sustainability Reporting Directive and the forthcoming EU Corporate Sustainability Due Diligence Directive. Private equity firms whose holdings include multinational businesses should thus keep abreast of Guideline developments.

The OECD has described the 2023 revisions as a "targeted update" to respond to new environmental, social and technological challenges that have emerged since the last revisions in 2011. Some of the key amendments include:

- recommending that businesses adopt a risk-based due diligence framework as outlined in the OECD's 2018 Due Diligence Guide;
- aligning the Guidelines with internationally agreed-upon goals and standards related to climate change and biodiversity;
- encouraging businesses to adopt responsible data governance strategies, conduct digital security risk management and carry out due diligence on the development and use of technology and data;
- focusing on the protection of vulnerable individuals and groups, especially during violent conflicts and other high-risk situations; and
- expanding due diligence expectations for corruption, bribery and lobbying.

Each Member State has established its own office for promoting implementation of the Guidelines within that state, known as a National Contact Point for Responsible Business Conduct ("NCP"). Importantly, the NCPs also provide a nonjudicial grievance mechanism to address cases of alleged nonobservance of the Guidelines by companies headquartered or operating in the NCP's jurisdiction.

Any individual or organization with a legitimate interest in a case of alleged nonobservance of the Guidelines can file a complaint with the appropriate NCP. The process generally begins with the NCP soliciting comments from the complainants and multinational enterprises involved and then making an initial assessment regarding whether the issues raised in the complaint warrant further investigation. If the NCP determines further examination is warranted, the NCP then offers a non-adversarial platform for the complainant and the multinational enterprise to reach agreement on possible remedies. If the parties reach agreement, the NCP reports on the agreement and can make further recommendations. Alternatively, if no agreement is reached, or

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International Disputes/ Business and Human Rights

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the initial assessment finds that the case does not merit further investigation, the NCP issues a final statement on the case, including any recommendations. Thereafter, the NCP may follow up on the parties' implementation of the agreement or the NCP's own recommendations.

Since the grievance mechanism was first introduced in 2000, NCPs have handled more than 650 cases involving operations in over 105 countries and territories. Complaints have been steadily increasing in recent years, and we expect this trend to continue. While participation in the specific instance process is voluntary for multinational enterprises named in a grievance, there may be good reason for an enterprise to engage proactively with the complainants and present its case. Indeed, an enterprise may welcome the opportunity to resolve a pending dispute through the non-adversarial methods offered by the NCP and to engage directly, proactively and constructively with stakeholders. Such engagement may also serve as an alternative to lengthy, public litigation and provide an opportunity to correct the record. Any enterprise considering engagement with an NCP specific instance process should consult with counsel to ensure participation is undertaken carefully and thoughtfully.

Please see our Debevoise In Depth for a detailed analysis of the 2023 Guideline revisions as well as key considerations for multinational businesses navigating the nonjudicial grievance mechanism.

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