McDermott Will & Emery

PRIVATE MARKETS UPDATE

SUMMER 2024 | IN THIS ISSUE:

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PRIVATE MARKETS FOREWORD: THE START OF A LOT MORE

Harris C. Siskind and Aymen Mahmoud

This year began with a lot of expectation. There was an expectation (and hope) that interest rate reductions would be forthcoming (along with other macro softening), that some of the challenges underpinning reduced merger and acquisition (M&A) volumes would fall away, that financing markets would become more accessible, and that political uncertainty would wane and a period of stability would underscore a strong return to growth.

Any period filled with such expectation attracts both optimism and an equal dose of pessimism. If markets are hot, pessimists will compare them to the overheating of 2021. Optimists, on the other hand, will argue that while 2023 saw green shoots of recovery, 2024 has started with fruit.

What do we see in our day-to-day practice? Macroeconomic data has undoubtedly improved. Whether within the Federal Reserve or the Bank of England (BoE), there is a growing expectation that rates will soon be reduced. At the BoE's last Monetary Policy Committee meeting, one vote already moved to reduce rates. UK inflation is at its lowest in three years at 2.3%, outpacing the US equivalent at 3.4%. The end of May even saw some US retailers cutting prices to pre-pandemic levels to offset the effects of recent increases, signaling that not only do policymakers have a solution for inflation but so do large corporates.

As macroeconomic indicators have stabilized, we have witnessed a subsequent increase in M&A volumes. The first quarter of 2024 saw a 36% increase in global deal value and, anecdotally, CEOs are more regularly discussing plans to make acquisitions and divestments. This suggests that valuation expectation differentials have softened and that both sellers and buyers are more willing to transact.

The 20% increase on US M&A deal volume at the start of 2024 (following a 17% contraction in 2023) suggests a return to near pre-pandemic levels, lagging by less than 5%. On the private equity side, signs indicate a rebound of 16% in 2024, contrasting the 15% contraction in 2023. While this is behind the peak seen in 2021, it represents a higher pace of growth than the 9% annual average from 2010 to 2019.

This brings us to the importance of 2021 as a barometer for activity. 2021 is widely regarded as the most active period in recent times. Many will recall the "why is it like this" dynamic that pervaded deals that year. If we use 2021 as a benchmark for deal activity, we are likely to be despondent about coming years. If comparing to pre-pandemic periods and accepting that debt, the facilitator of so many transactions, is no longer almost free, then the comparison is a far more appropriate one – and one that shows a story of sustained growth.

As for debt markets today, they are getting quite hot. The market has been littered with repricings and the US syndicated market has returned, influencing the European market in the same way. Leveraged credits across institutional loans were at more than $300 billion in the first quarter of 2024, compared to $72 billion in the first quarter of 2023.

"Return of the banks" has dominated conversations so much recently that institutions such as Citibank and LuminArx have partnered to raise direct lending alternatives, as have Wells Fargo and Centerbridge Partners through Overland Advantage. Has private credit reacted to the return of the bank or bank-combined offerings? Statistics suggest no, with private credit representing 24% of the $3.8 trillion in US assets under management over sub-investment grade credit, compared to 5% in 2005.

What is transpiring, however, is a tightening of terms, whether economically with private credit deals pricing spreads of 4.5% or on covenants with an increasing number of covenant-lite deals in the mid-market.

When discussing cross-border private markets, it's impossible to ignore global politics. Across the United States and the United Kingdom, we can expect significant political shifts in 2024. Against the backdrop of more stable environments and based on a variety of factors ranging from industry to geography, the private markets have been satisfactorily busy for many, extremely busy for others and patchier for some. Can politics impact that? Of course.

But recent years have shown that private markets are reacting less and less to general political shifts. Public markets are still far more reactive though, so in the second half of 2024 there is still much to play for.

What is clear is that the need for high-quality service on complex, cross-border work has not waned and is not expected to. We look forward to continuing to provide our clients with creative and dynamic solutions as we grow our relationships in the second half of 2024. It certainly promises to be a complex but productive market.

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MARKET ANALYSIS

Welcome to the third edition of McDermott Will & Emery's *Private Markets Update* in which our cross-border, multidisciplinary team shares their insights on the latest trends emerging from global private markets. In this edition, we examine developments in the markets over the first half of 2024, and highlight some of the key issues facing investors as we move into the second half of the year.

Like the previous reports, this issue sets out to cover a diverse range of topics and talking points across the private markets, ranging from cross-border restructuring trends to merger obstacles in Europe, opportunities for private equity in the business services and healthcare spaces, and the latest regarding the regulation of private credit.

Once again, we examined the most recent data and pooled our shared experiences to bring you the "10 Trends to Track" list: our pick of the most pertinent themes in the current market and an attempt to underscore the backdrop in which investors are operating. While many dealmakers had a positive start to 2024, this year remains characterized by uncertainty, caution and a tight mergers and acquisitions (M&A) market.

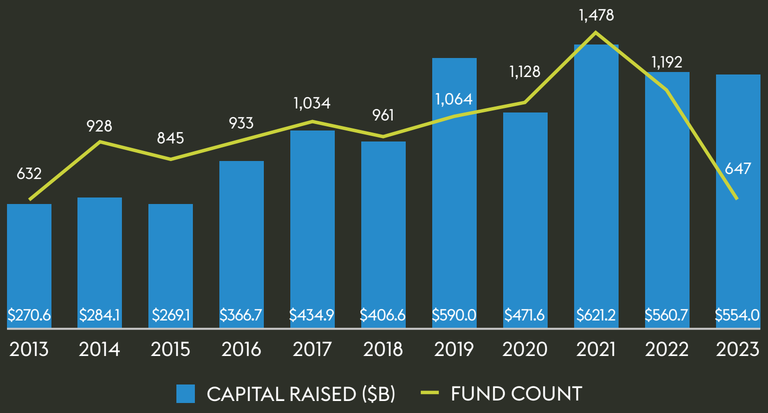
With fundraising down across certain facets of private markets, exit activity still in recovery and distributions to limited partners (LPs) largely below ideal levels, dampeners holding back transactions remain even as recovery continues. Still, the private markets are nothing if not agile and adaptable, and with the prospect of interest rates starting to lower, we look forward to more deals getting done in the latter part of 2024.

TREND 1 FUNDRAISING RECOVERY ACROSS ASSET CLASSES

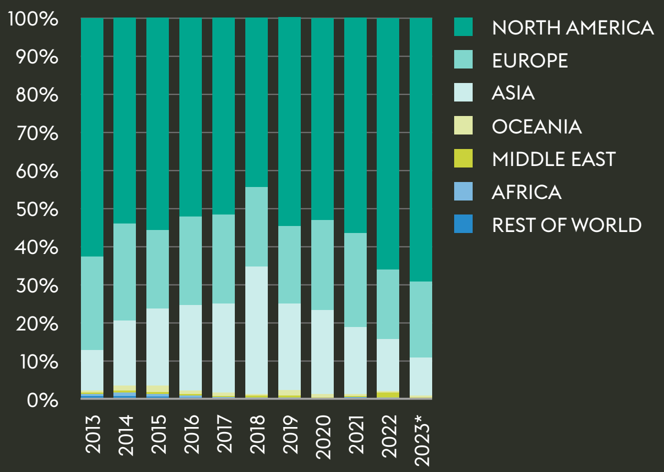
Year-end figures for 2023 show that fundraising was down across asset classes, with the number of private equity funds raised dropping to 647 according to Pitchbook data, almost half the volume seen in 2022 and the lowest level in a decade. The total capital raised held up much better with $554 billion entering private equity coffers, highlighting the record levels of dry powder that now sit on the sidelines ready for deployment. It is also clear the most successful funds continue to attract significant investor appetite, as seen by CVC Capital Partners' record €26 billion buyout fund and Oaktree Capital Management's more than $18 billion raised for opportunistic credit.

While investors were cautious about allocating capital last year because of high inflation, rising interest rates and geopolitical uncertainty, the challenge for private markets was compounded by a denominator effect in portfolios and a slowdown in the pace at which capital was getting back to LPs. With many of these issues starting to abate through 2024, we are now seeing more follow-on and deal-by-deal investments from LPs as they show an increased willingness to transact ahead of making substantial commitments to new fundraises targeting the end of the year and 2025.

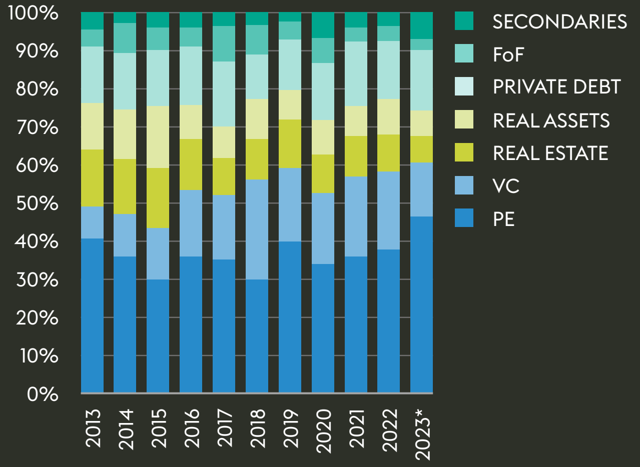
PE FUNDRAISING ACTIVITY



SHARE OF PRIVATE CAPITAL FUNDS BY REGION



SHARE OF PRIVATE CAPITAL FUNDS BY TYPE



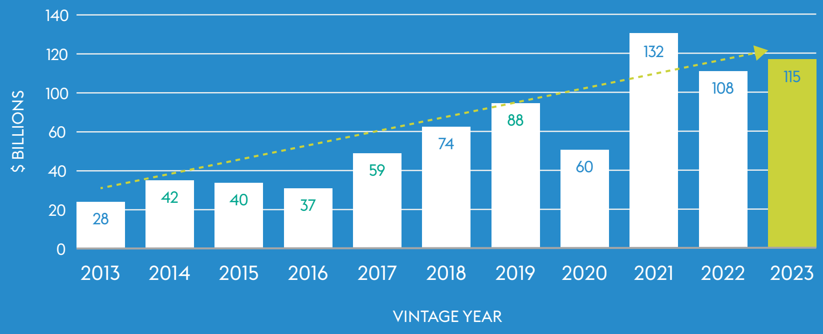
SOURCE: PITCHBOOK | GEOGRAPHY: GLOBAL | *AS OF DECEMBER 31, 2023

TREND 2 GROWTH OF SECONDARY MARKETS

Overall secondary market deal volume continued to grow in 2023, with the market now having grown fourfold over the past 10 years to reach $115 billion in closed transactions. With notable expansions in infrastructure and private credit secondaries in particular, it is clear that LP appetite for liquidity in private markets – along with the growth of underlying asset classes and in available secondary dry powder – continues to fuel activity.

4X MARKET GROWTH IN 10 YEARS...

TOTAL SECONDARY MARKET CLOSED TRANSACTION VOLUME



...AND WELL POSITIONED FOR CONTINUED EXPANSION

$10TN PRIVATE CAPITAL BAV (2023) → ~1% → **$115BN** 2023 SECONDARY VOLUME CLOSED

$145BN SECONDARY AVAILABLE DRY POWDER = **1.3X** DRY POWDER VS. 2023 SECONDARY VOLUME

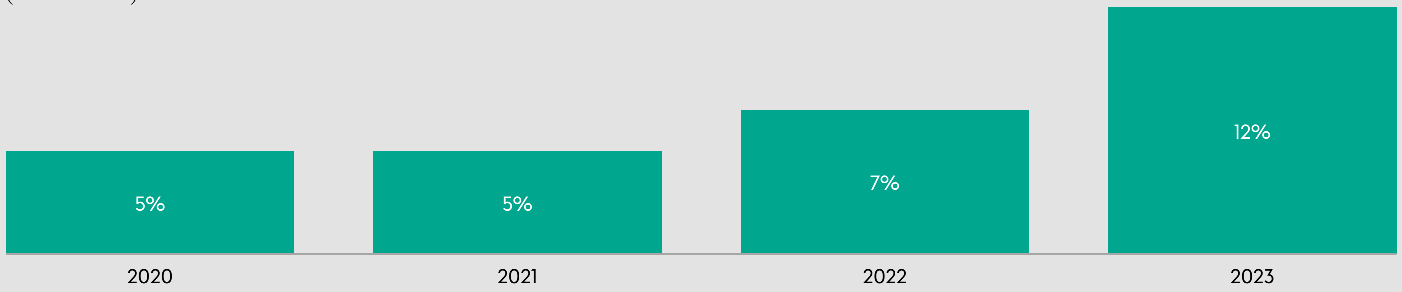
SOURCE: BLACKROCK | EXPECTATIONS MAY NOT COME TO PASS | ALL DOLLAR FIGURES IN USD

TREND 3 INCREASING FOCUS ON GP-LED SECONDARIES

The appetite among both general partners (GPs) and their investors to execute GP-led secondaries continued to increase last year, and we see that gaining momentum throughout 2024. High interest rates and pricing on transactions has resulted in a slowdown in the sales of portfolio companies, leaving LPs in need of liquidity. GPs with good quality assets are increasingly opting to hold onto those assets for longer in continuation vehicles, allowing LPs to either capture liquidity or rollover to stay with the asset and creating opportunities and value for sponsors and investors alike.

GP-LED AS % OF SPONSOR-BACKED EXIT VOLUME

(% of volume)



SOURCE: BLACKROCK

TREND 4 EXITS ARE BOUNCING BACK

The last few years have been tough for sponsors looking to exit on investments, with M&A activity down and initial public offering (IPO) markets largely shut. Both shifted in 2024, and we've seen a growing volume of exit activity and some reopening of the IPO window (even if the exit pace is still steady). Figures from Dealogic suggest that exit value may bounce back across 2024, heralding a much-needed uptick in capital flows.

GLOBAL BUYOUT-BACKED EXIT VALUE ($B)

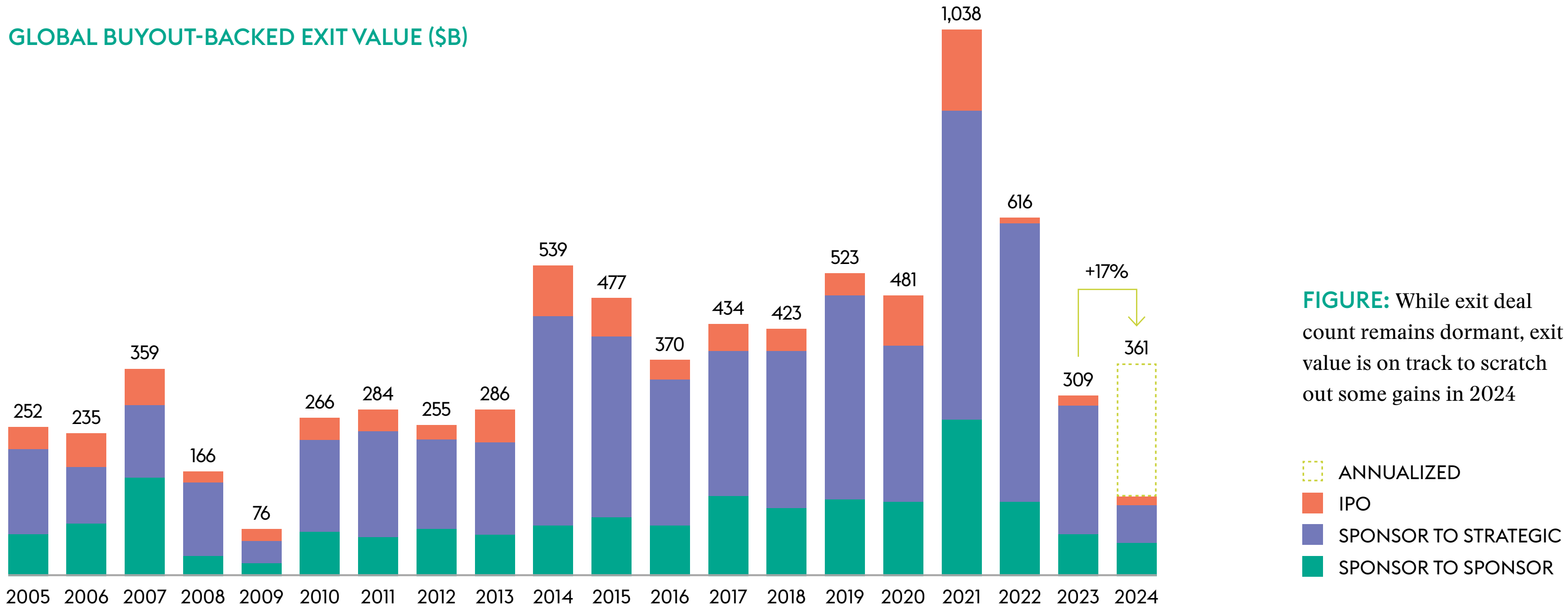


FIGURE: While exit deal count remains dormant, exit value is on track to scratch out some gains in 2024

SOURCE: BAIN · DEALOGIC

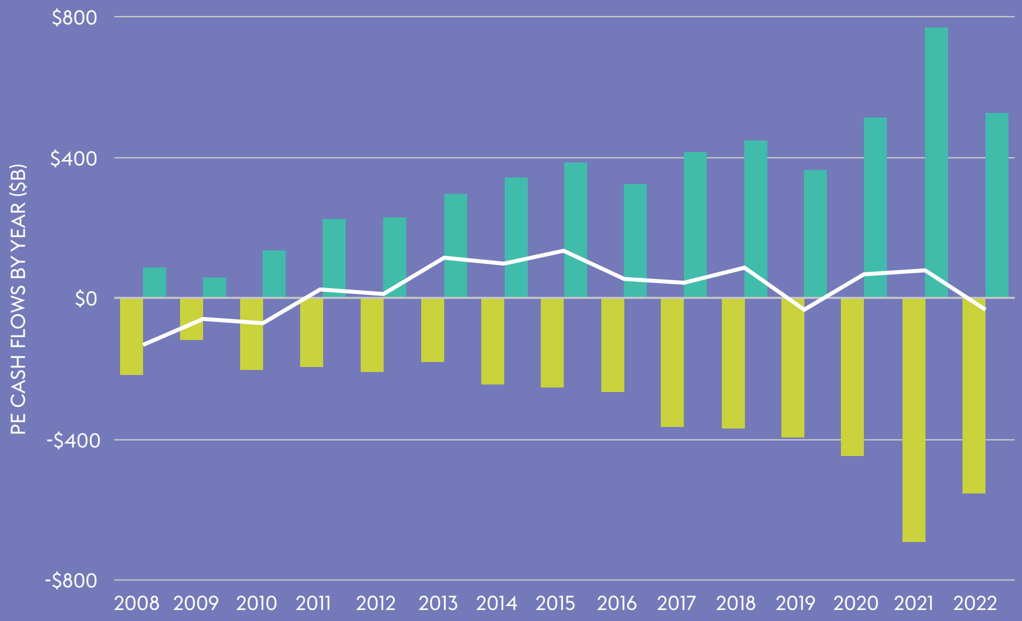
NOTES: INCLUDES PARTIAL AND FULL EXITS, BANKRUPTCIES EXCLUDED; IPO VALUE REPRESENTS OFFER AMOUNT, NOT THE MARKET VALUE OF COMPANY; FIGURES HAVE BEEN ROUNDED

TREND 5 LPs LOOK FORWARD TO A DISTRIBUTIONS REBOUND

As we have seen, exit activity dropped in 2022 and 2023 as sponsors opted to hold assets for longer in the face of challenging M&A markets. That caused investor-related distributions to slow just as capital calls picked up, making LPs more careful when deploying additional capital in new funds.

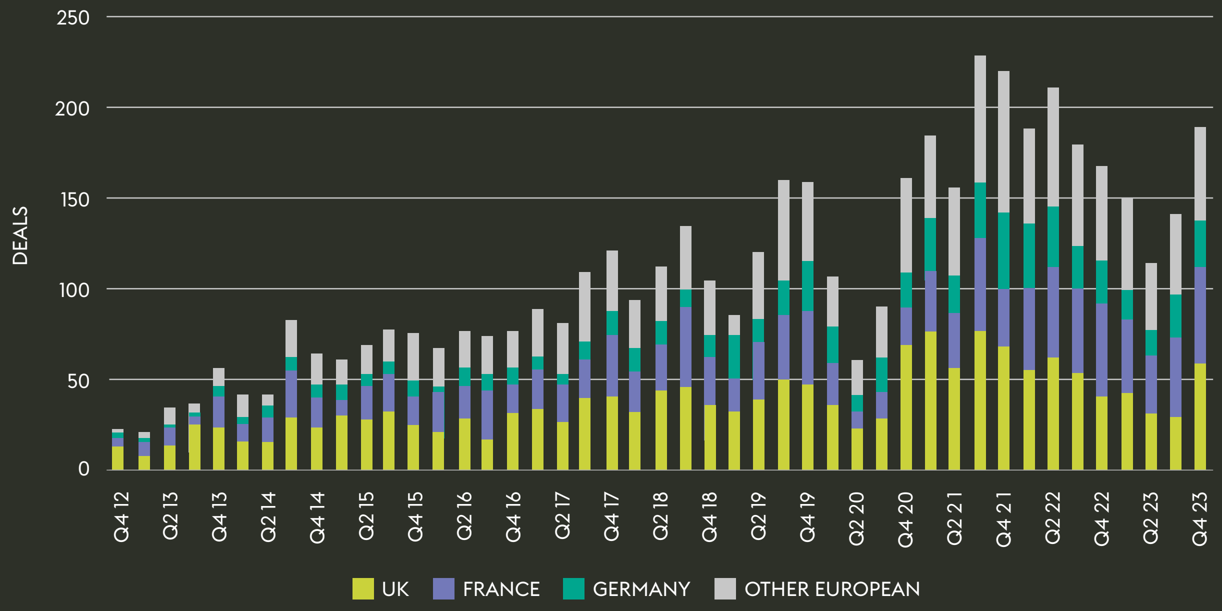
Data from Pitchbook shows private equity cashflows turned negative in 2022 for only the second time since the global financial crisis. As we move through 2024, we see LPs in a much stronger position given a focus by GPs on returning capital. And with more funding in the system, we expect activity to pick up across the board.

PE CASH FLOWS BY YEAR ($B)



SOURCE: FRANKLIN TEMPLETON · PITCHBOOK, AS OF 12/31/22

DELOITTE PRIVATE DEBT DEAL TRACKER | UK AND EUROPEAN DEALS



TREND 6 A GOLDEN AGE FOR PRIVATE CREDIT

The penchant among private markets to underwrite technology investments in Europe showed no signs of slowing in 2023, with software and information technology (IT) proving to be the sector that held up the best in terms of volume and value. By the start of November 2023, $67 billion had been spent on IT deals in European PE alone while $72 billion was spent in all of 2022. The sector continues to be featured heavily across PE, private credit and venture capital as investors have moved to back growth, innovation, recurring revenues and strong margins in the face of uncertainty.

4879
total deals completed

3251
Euro deals completed

1628
UK deals completed

TREND 7 **INCOMING MATURITIES (BUT WITHOUT WALLS)**

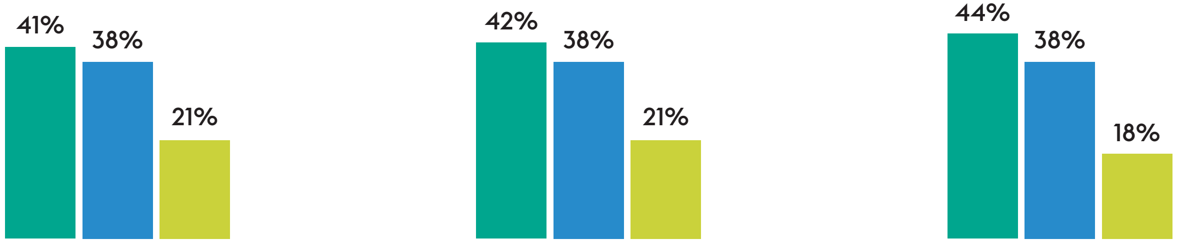
The amount of debt maturing over the coming years is creating opportunities for refinancing markets as borrowers look to revisit facilities agreed on at lower rates in markedly different environments. While lenders can look forward to a bullish period of activity, some businesses may need to look at financial restructurings if they are finding it more challenging to adapt to a higher-for-longer rates backdrop. The usual dysphemisms around "walls of maturity" ought to be recast as simply a period of refinancing as borrowers and lenders work together to optimize capital structures.

REFINANCING DEMANDS LOOM

DEBT MATURING IN THE NEXT:	12 MONTHS	24 MONTHS	36 MONTHS
Total debt maturing	$2.0 tril.	$4.5 tril.	$7.3 tril.
Percentage of total debt	8.5%	19.3%	31.1%
Speculative-grade share	12%	17%	20%
Amount rated 'B-' and lower	$60.4 bil.	$214.0 bil.	$441.4 bil.

Regional breakout

UNITED STATES
EUROPE
REST OF WORLD



SOURCE: S&P GLOBAL RATINGS CREDIT RESEARCH & INSIGHTS

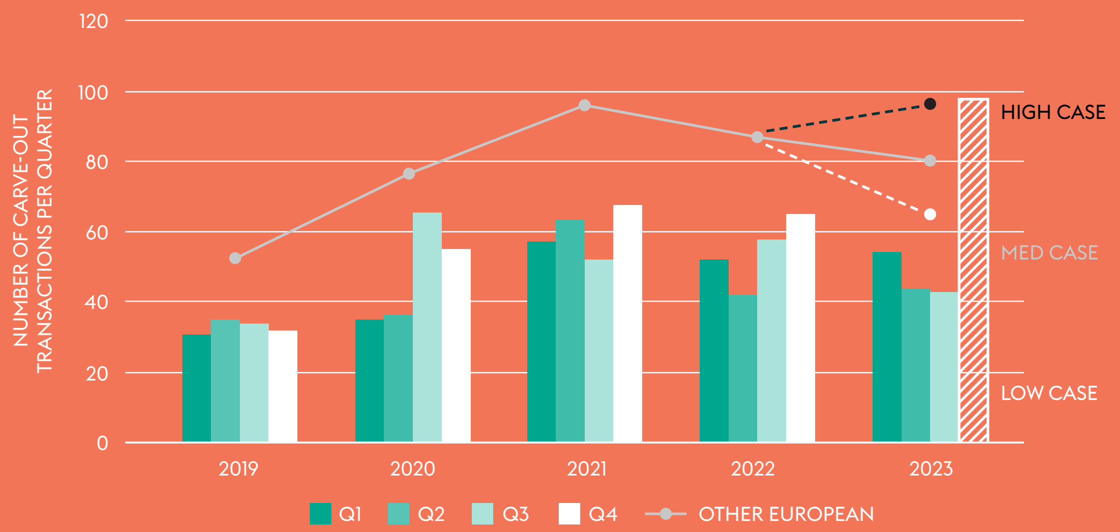
NOTES: DATA AS OF JANUARY 1, 2024. INCLUDES FINANCIAL AND NONFINANCIAL CORPORATES' BONDS, LOANS AND REVOLVING CREDIT FACILITIES THAT ARE RATED BY S&P GLOBAL RATINGS.

TREND 8

CARVE-OUTS: A GROWING DRIVER OF M&A VOLUME

With high interest rates and persistent inflation, businesses that have been feeling the pressure for a year or more are now starting to experience financial difficulties. Predictions from Fitch Ratings in August 2023 anticipated default rates rising across Europe into 2024, with leveraged loan defaults currently at 1.7% and likely to increase to 4%. Higher borrowing costs and deteriorating growth prospects are equally felt across private market portfolios, though we're currently seeing more consensual processes between sponsors and lenders as steps are taken to address capital structure issues and avoid covenant breaches and defaults. For now, the rising default rates remain below market expectations, particularly in the mid-market, as funds work to support the solid businesses navigating challenging situations.

NUMBER OF CARVE-OUT TRANSACTIONS



SOURCE: CAPITAL IQ · BDO ANALYSIS

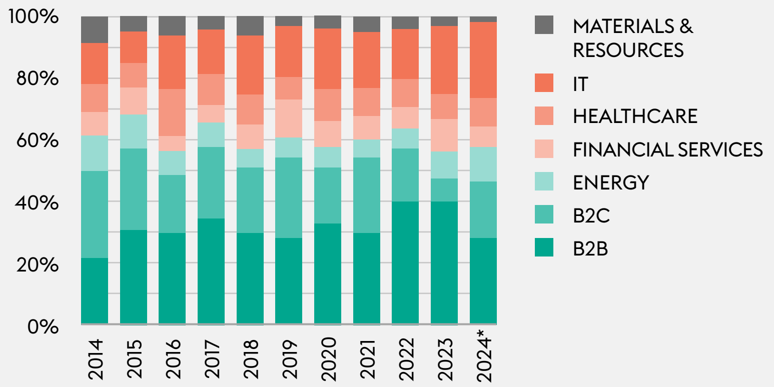
TREND 9

HEALTHCARE AND BUSINESS SERVICES CONTINUE TO PERMEATE PRIVATE EQUITY ACTIVITY

In recent years we have seen a clear bifurcation emerge in private equity deal markets as two sectors have come to feature widely in sponsors' transactional activity: healthcare and business services, including software and IT.

Despite the bumpy ride that M&A markets and valuations have endured since the COVID-19 pandemic, these two sectors remain dominant, with the thematic growth drivers that underpin opportunities across healthcare, business-to-business and IT continuing to fuel a large proportion of deal activity.

SHARE OF PE DEAL VALUE BY SECTOR



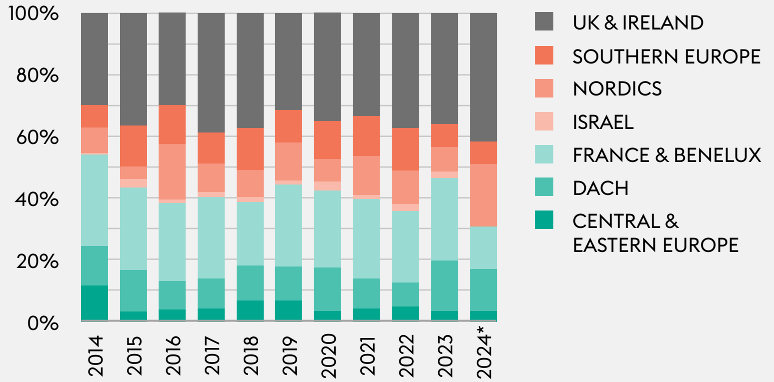
SOURCE: PITCHBOOK · GEOGRAPHY: EUROPE · *AS OF MARCH 31, 2024

TREND 10

SOME EUROPEAN MARKETS ARE BUSIER THAN OTHERS

As deal markets start to rebound across Europe, transactions are picking up in all the core geographies. We see increased activity in the more mature UK, DACH region and French private markets, while the Nordics, Benelux and Southern European regions also present growing opportunities for investors looking to pursue cross-border strategies and expand sourcing footprints.

SHARE OF PE FUND COUNT BY REGION



SOURCE: CAPITAL IQ · BDO ANALYSIS

UNITED STATES

BENEFITS OF SPECIALIZATION FOR HEALTHCARE PRIVATE EQUITY FUNDS

Ian M. Schwartz

In recent years, private fund managers have faced significant headwinds in connection with capital formation and fundraising efforts, including in the private equity space. New firms in particular face barriers to entry in an extremely competitive market at a time when investors have limited capital to deploy and are focused on the rate of distributions from their current fund investments.

In 2024, however, funds focused on healthcare investments show signs of bucking these trends as capital floods into highly specialized firms. The lower middle market specifically has served as a viable target for capital in search of above market returns in this sector.

IN FACT, MANY FIRMS THAT ADOPTED INVESTMENT STRATEGIES LIMITED TO HEALTHCARE AND HEALTHCARE-ADJACENT BUSINESSES HAVE BEEN GENERATING RELATIVELY OUTSIZED RETURNS.

Trending industries such as value-based care serve as useful targets for investors willing to underwrite more niche windows of opportunity.

Limited partner (LP) interest in healthcare-specific investment strategies has also allowed new firms to emerge that have chosen a specialist approach to investment opportunities. These LPs are attracted not only to healthcare, but to improving healthcare systems globally via capital deployment and investment in infrastructure that can enhance access and deliver better outcomes. The combination of outsized returns and a socio-politically impact investment opportunity in healthcare has led to an LP base that is willing to bear risks and deploy capital. These LPs are also attracted to the competitive advantage afforded to firms that focus on a highly specialized market, such as healthcare.

At McDermott's 2024 HPE Miami event, we polled a large audience of industry professionals on their outlook for the fundraising environment. A majority of those polled do not expect private equity fundraising to return to 2021 levels over the next three years, nor do they think 2024 will be a better market for first-time managers than 2023. Instead, four out of five of attendees surveyed agreed that large funds and established managers will take a growing share of total fundraising, as has been the trend the last few years. Standing out in such an environment is challenging, but healthcare strategies appear to have an edge in standing out.

80%

of attendees surveyed agreed that large funds and established managers will take a growing share of total fundraising.

THE ADVANTAGE OF FOCUS: SPEED, RISK AND UNDERSTANDING

Healthcare specialization in private equity firms generates several distinct benefits as funds identify sophisticated projects, act quickly and bear risks.

1. All levels of firm personnel of an effective healthcare specialized private equity firm, from analysts and directors to investment committees, are highly educated and familiar with relevant elements of the healthcare systems in question. This can remove information asymmetry issues sometimes present in the relationship between investors, committees and LPs.

2. At specialized firms, managing directors can quickly identify the projects many generalists may miss, analysts can quickly model opportunities, and well-versed investment committees can then swiftly measure risk and approve complex opportunities that could face more information barriers in committees run by generalists. Having built strategies focused on niche areas of the healthcare economy, specialized firms can also deploy the same models repeatedly on different but related targets, benefitting from the efficiency of not having to start from scratch each time.

3. Additionally, as healthcare investing has matured so has the sophistication of its LP base. LPs have familiarized themselves with megatrends in the healthcare economy, whether that relates to the intricacies of US systems, such as Medicare and Medicaid or the country-by-country nuances in play when navigating pan-European roll-up strategies. Educated LPs allow fund managers to easily communicate complex healthcare investment strategies and take risks without the fear of alienating investors. A well-informed LP becomes an asset and an advocate for a firm rather than a roadblock.

Most attendees at HPE Miami 2024 shared via the event polls that they were optimistic about the outlook for healthcare transactions this year.

THE DEALS OUTLOOK

Most attendees at HPE Miami 2024 shared via the event polls that they were optimistic about the outlook for healthcare transactions this year, suggesting there will be more opportunities for fund deployment. The labor market challenges that beset healthcare assets in 2023 will not likely disappear in 2024, but buyers seeking scalable assets with sustainable growth levers can expect more deal flow.

Signs of credit markets opening in the first half of the year, along with bid-ask pricing convergence, suggest healthcare private equity activity should unlock in the coming months. Nearly half of those surveyed at HPE Miami felt that prices will settle over the next year at a level closer to the prices that buyers are willing to pay, with 46% predicting transactional activity will not ramp up until the fourth quarter of 2024.

Pharma services is predicted to be the most active subsector. With the pharma industry anxious for faster drug-to-market activity and with pharma services the obvious catalyst to make that happen, the great promise that tech and AI present when it comes to fueling clinical trial subject recruitment and results analysis further explains investor appetite. The physician services space is also expected to be busy with deals, while digital health and health IT will offer the best returns for growth equity.

As transactional activity rebounds in the complex healthcare space, specialization will continue to serve as a differentiator both in relation to fundraising and dealmaking. The return to specialization has proven within the healthcare sector to be appealing to investors looking to increase their exposure to the sector, as such, it's little wonder that dedicated healthcare managers stand ready to reap rewards from a more robust market going into 2025.

KEY TAKEAWAYS

- Fundraising environment has been challenging for many PE funds for the last few years.
- Specialist healthcare strategies are attracting investor appetite.
- LPs are drawn to potential outsized returns and opportunities for positive societal impact.
- Newer managers need a way to stand out in a market dominated by established managers
- Specialists often benefit from quick executions and an industry specific understanding of risk.
- The complex healthcare regulatory landscape favors experienced players.
- Well-informed LPs are familiar with megatrends in the healthcare economy.
- With the deal market picking up (but still highly nuanced), specialists are likely to thrive.

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UNITED KINGDOM / UNITED STATES / GERMANY

CROSS-BORDER REGULATION OF PRIVATE CREDIT

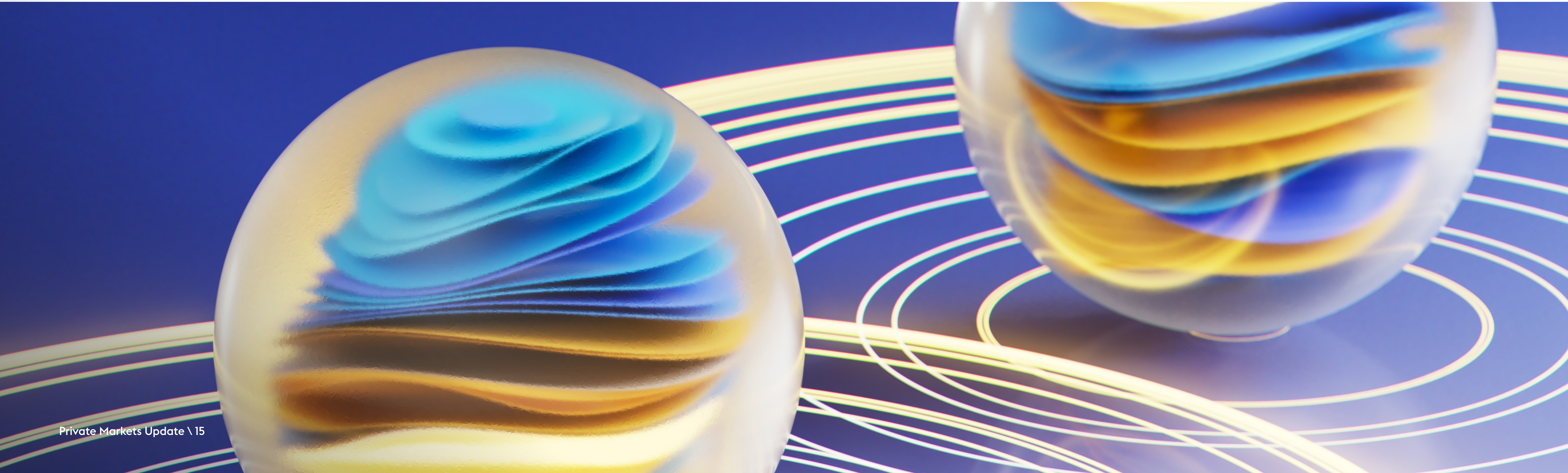
Aymen Mahmoud, Riley T. Orloff and Dr. Matthias Weissinger

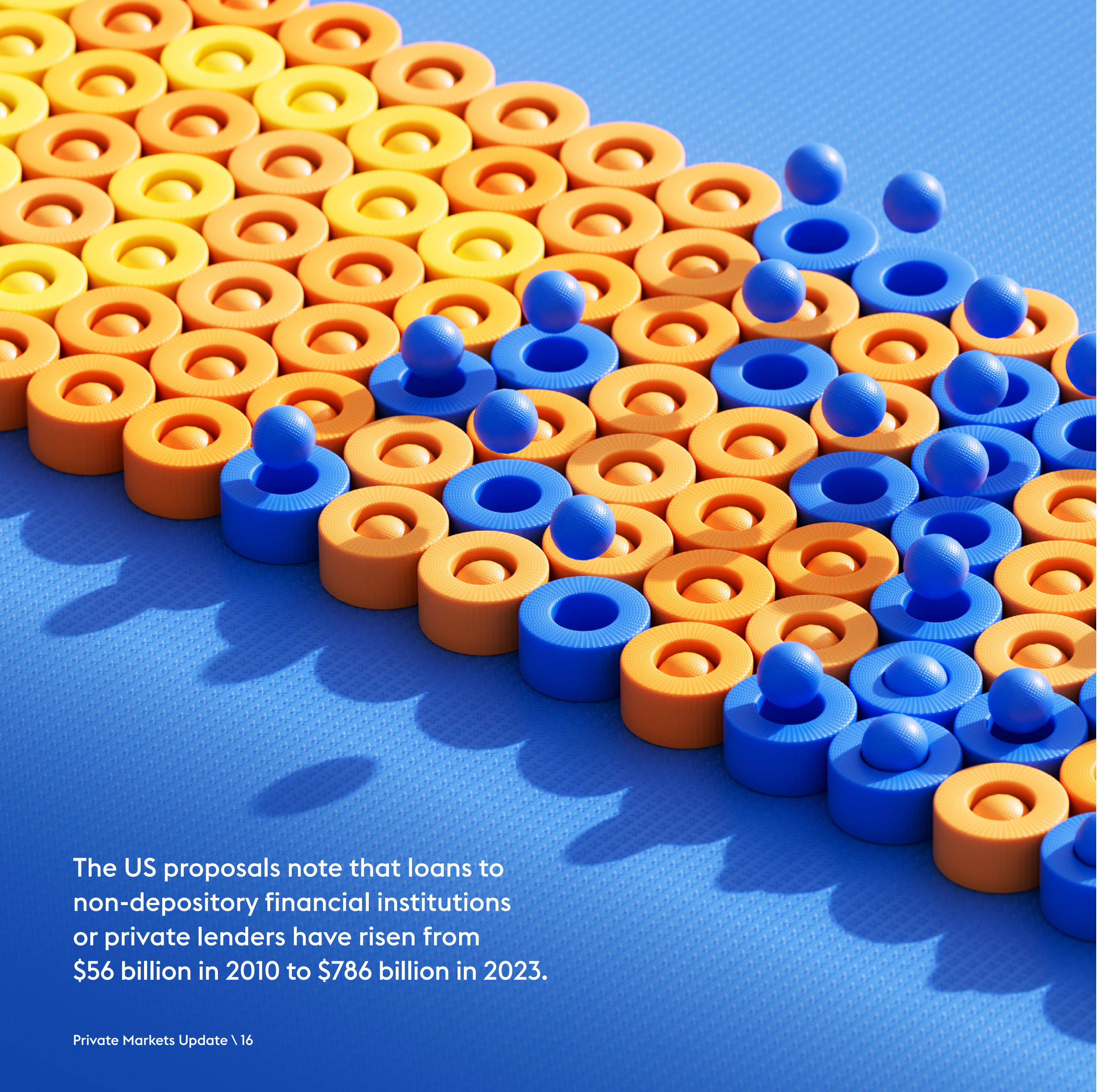
It's no secret that direct lending markets are growing at a remarkable pace. As investment managers look to provide their investors with stable risk-adjusted returns, the flight of capital to private credit has taken the asset class to upwards of $2 trillion in value. Additionally, the product offering has evolved into the most sophisticated general lending product seen in the leveraged finance markets.

Coupled with the contraction of balance sheet bank lending and the associated complexities that have impacted the broadly syndicated market since the global financial crisis (GFC), lending markets had a hole that was perfectly filled by private credit.

But the improper use of credit was a significant cause of the GFC and the absence of credit is possibly the most far-reaching consequence. Credit became the poster child for regulation when things turned sour – and rightly so. People didn't understand what the banks were doing. Obfuscation around collateralized debt obligation and collateralized loan obligation actualities was so rife that films like "The Big Short" were able to caricature the events leading up to the GFC so that the average person with no connection to the markets could understand them.

For private credit, history's lesson appears to be that where a lot of profit has been generated and where a lot of money is deployed, regulators will need to step in to avoid repeating the GFC's impact. But are the two situations alike, or





The US proposals note that loans to non-depository financial institutions or private lenders have risen from $56 billion in 2010 to $786 billion in 2023.

are regulators looking for trouble in the wrong place? Are they better served applying their regulatory oversight elsewhere?

GROWING SCRUTINY

As we entered 2024, we saw increased chatter around the regulation of private credit and private equity that was propelled either by their meteoric growth or their relative slowdown since 2021.

What have regulators been focused on? Is their focus global or more localized/ supranational? Is there a risk of imbalance? Why now? Are there systemic issues facing the global economy that are underwritten by private credit or private equity that we weren't aware of? Are the general public and "retail" investors as exposed to these private credit and private equity markets as they were to the bank lending industry during the GFC?

If the answers to at least some of these questions are not singularly compelling, then it seems the case for regulation in what is largely an egalitarian economy is predicated on a fear of market disorder caused by the destabilization of an extremely private enterprise.

REGULATORY PROPOSALS

The current proposed regulations are best split into two. The United States has the proposed non-depository financial institution regulations while Europe has the Alternative Investment Fund Managers Directive.

The US proposals note that loans to non-depository financial institutions or private lenders have risen from $56 billion in 2010 to $786 billion in 2023. Their focus is on asset managers with upwards of $10 billion in total assets, and their output centers around reporting. Institutions that fall above the threshold are required to undertake reporting covering items, such as loans to credit funds and loans to private equity, and reporting unused commitments.

These reporting requirements do not create regulatory requirements in themselves. Instead, they help regulators intervene when they believe reported indices are suggestive of problematic or unsafe conduct.

The EU proposals also focus on the leverage taken on by lenders rather than on how much lending there is to a particular business, arguably because this granularity would be too broad brush. However, aren't the underlying assets of any asset manager the appropriate metric of their financial health just like how the underlying financial health of an individual enterprise is determined by its assets and liabilities? The EU proposals aim to cap leverage for closed-ended loan origination alternative investment funds or credit funds at 300% of their net asset value, with open-ended funds capped at 175%.

LESSONS LEARNED

Stakeholders supporting the EU proposals have raised concerns that the sector poses a risk to financial stability because of a vulnerability to macroeconomic shifts. However, this industry provided liquidity following the GFC, responding to a lending vacuum created by those very same macroeconomic shifts.

Many remember the leveraged lending guidelines imposed in 2013, which discouraged exposure lending at certain leverage levels. While they did not hold legal force, investment banks were careful not to fall outside of the guidance. Those rules drove borrowers to the wider capital markets rather than to more institutional relationship lending.

Companies were largely at the whim of those markets' emotions, unable to transact during periods of macroeconomic uncertainty despite their own solid business fundamentals. The absence of willing lenders was exacerbated by the absence of able lenders. Able, that is, to explain to public shareholders the acts of defiance by US regulators.

That very regulation helped the private credit industry engage a higher gear in its growth spurt, helped many companies and drove a significant number of economies where the credit underwriting decision was made analytically and not in a regulatory vacuum. Without those private credit funds, economic growth and innovation may have slowed for a decade (or longer).

The 2013 leveraged lending guidelines were rendered defunct under the Trump administration and have not resurfaced in form or substance before the US proposals. It may well be that history is the right teacher for credit markets, but maybe the lesson is not the under-regulation that led to the GFC. Perhaps it's the one-size-fits-all approach to regulation that we should be wary of in case it slows progress at a time when progress is especially needed.

KEY TAKEAWAYS

- Private credit has grown exponentially since the global financial crisis.
- Regulators are increasingly focused on the asset class.
- US proposals are focusing on more reporting for large credit funds.
- The EU plans to cap the leverage taken on by credit funds.
- Without private credit, economic growth may have slowed for even longer.
- A one-size-fits-all approach to rulemaking may slow progress.

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BELGIUM

OBSTACLES TO MERGERS IN THE EU

Hendrik Viaene and Stéphane Dionnet

Mergers and acquisitions (M&A) likely to impact the European Union's internal market have recently come under increased scrutiny.

Most companies are familiar with the merger control check that must be carried out: Is the transaction notifiable under the EU Merger Regulation (EUMR) or under one or more of its member-state-level equivalents? It used to be that if no merger filing obligations were triggered, the parties could quickly move on to closing the transaction. Sadly, that is no longer the case.

A WIDER NET TO CATCH TRANSACTIONS

The European Commission and national competition authorities (NCAs) are now looking for ways to review transactions they consider harmful for competition, even if they don't meet the notification thresholds.

The European Commission has brought new life to Article 22 of the EUMR, claiming it can review non-notifiable transactions if NCAs request the European Commission to do so – and even when national notification thresholds are not met. The final word has not yet been said about this approach, and a case is currently pending before the Court of Justice of the European Union (Case C-611/22 P *Illumina v. Commission*).

Additionally, in *Towercast* (Case C-449/21), the Court of Justice reanimated its 1970s case law, stating that the acquisition of another company may constitute an abuse of a dominant position when all conditions are met. These two developments cast a long shadow over the much-vaunted legal certainty that the EU merger control construct sought to bring about. Companies must take this into account when planning a transaction, particularly when negotiating long stop dates and the penalties for not meeting them.

Furthermore, since the United Kingdom's exit from the EU in 2020, the UK and the EU became two fully distinct regulatory, legal and customs territories, meaning the UK Competition and Markets Authority (CMA) is now permitted to investigate transactions in parallel with the European Commission.

It should be noted that the CMA may adopt a different position from that of the European Commission when it comes to merger control. This is particularly true for new technologies where there have been a significant number of different outcomes in merger control enforcement.

For example, in June 2023, the CMA unconditionally cleared Amazon 's proposed acquisition of US-based robot vacuum cleaners manufacturer iRobot , whereas the European Commission opened an in-depth investigation and requested demanding commitments from Amazon. As a result, Amazon abandon its project entirely in January 2024.

FOREIGN DIRECT INVESTMENT REVIEW

Another important obstacle is foreign direct investment (FDI) review. At the EU level, in 2019, a new FDI regulation was published to protect European companies, workers and citizens by screening foreign investment in transactions involving competing European and non-European companies.

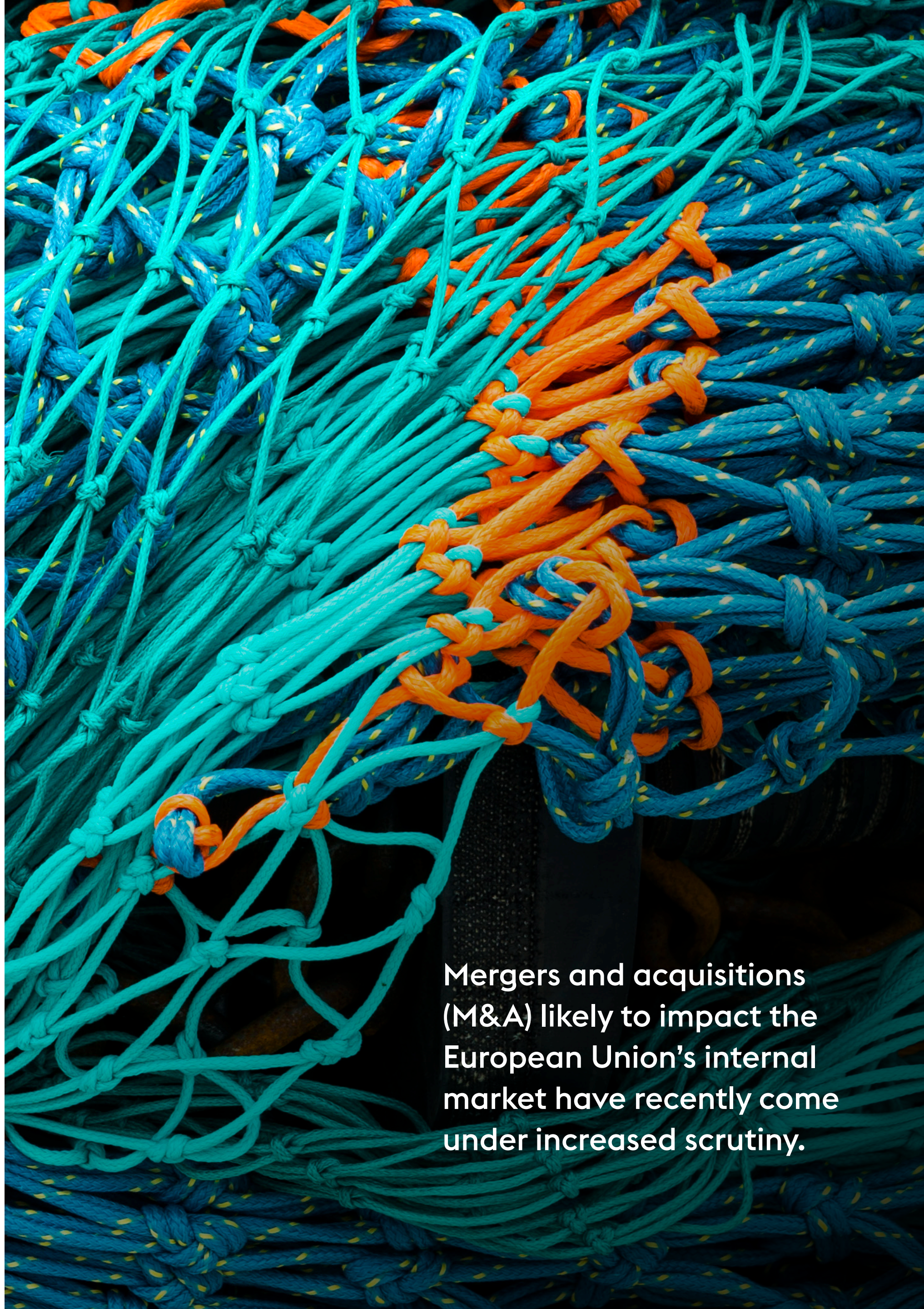
The FDI regulation does not create an FDI screening mechanism at an EU level but sets out minimum requirements for EU Member States' FDI screening mechanisms and a mechanism for coordinating FDI reviews. To date, 22 out of 27 EU Member States have adopted their own separate FDI screening regimes while the other five Member States are either in the process of adopting such regimes or have initiated steps to do so.

Under the FDI regulation's cooperation mechanism, the Member States and the European Commission may issue comments and opinions on transactions involving FDIs in another Member State's territory. Ultimately, each host Member State must issue a decision as to whether it allows FDI.

The practical implications of these new FDI regimes for M&A in the EU can hardly be overstated. As with merger control and foreign subsidies reviews, FDI screenings will affect the timing of transactions in every Member State. No deal can be closed before receiving the approval of the respective screening authorities.

FOREIGN SUBSIDIES REVIEW

Adopted in December 2022, the Foreign Subsidies Regulation (FSR) introduces a new tool for the European Commission to prevent foreign subsidies from distorting the EU internal market and creates an additional layer of deal conditionality for sizeable transactions alongside FDI and merger control clearance.



This regime may delay the closing of transactions and imposes a significant additional compliance burden for companies in terms of gathering information to complete the notification forms.

Under FSR, a mandatory pre-closing notification must be filed when engaging in a transaction that meets the following thresholds:

- The target, joint venture or one of the merging parties is established in the EU and generates a turnover of at least €500 million in the EU.
- The parties concerned received aggregate foreign financial contributions of at least €50 million in the three financial years prior to notification.

Foreign financial contributions encompass a broad range that includes capital injections, loans, guarantees, tax exemptions, contracts with public authorities and investments by sovereign wealth funds and/or state-owned companies.

The parties involved in these transactions must provide correct and complete information via Form FS-CO. Based on this form, the European Commission will assess whether foreign subsidies are distorting the EU internal market and, if so, whether it should prohibit the transaction or whether other remedies might apply.

As of mid-May 2024, the European Commission received 78 pre-notification requests under the FSR. Of those 78 requests, 38 were initially investigated but cleared during Phase 1. No transaction was subject to an in-depth FSR investigation by the European Commission.

CONCLUSION

Merger control, FDIs and the FSR are three regimes that coexist independently and must be assessed in parallel for any planned transaction. As each of these regimes contain a bar on closing, careful planning and assessment is required to avoid deals being blocked or closing timelines proving unrealistic, thus putting parties under avoidable pressure.

KEY TAKEAWAYS

- Deals that aren't notifiable under the EU MR are no longer necessarily free to proceed.
- NCAs can now ask the European Commission to review deals.
- An acquisition might also be deemed an abuse of dominant position.
- The CMA can run its own investigations.
- FDI reviews can significantly impact deal timelines.
- FSR rules can impose an additional compliance burden.
- The merger control, FDI and FSR regimes must be assessed in parallel to avoid bars on closing or significant deal timeline issues.

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FINANCING CHALLENGES FOR HEALTH AND LIFE SCIENCES INVESTORS

Aymen Mahmoud and Ettore Scandale

The broader macro and geopolitical landscape has created a particularly challenging financing environment for health and life sciences investors in 2023. Uncertainty and the higher cost of capital has driven lender reticence, resulting in a flight to quality borrowers and top-tier assets. As a result, high-quality assets continue to transact at values largely unchanged from a year ago, but for others it's difficult to convince lenders to engage.

Meanwhile, cash-strapped biotechs have been forced to leverage relationships with Big Pharma to address liquidity. We've noted that cash is king in a financing environment, and because the biotech industry requires a lot of cash it has had to adapt the most. For companies that were unable to tap into Big Pharma, the alternative was to streamline the business and prioritize core business lines.

For lenders, the focus has been on downside risk in an uncertain environment, so the favored assets were those with sustainable cashflows and the ability to create true growth. This led to more activity in generics and well-positioned contract development and manufacturing organizations, as well as an increased spotlight on relationships with management teams.

For lenders, the focus has been on downside risk in an uncertain environment

Some of the lenders that joined us at our 2023 European Health & Life Sciences Symposium spoke about the need for borrowers to be able to tell a clear and compelling story about their business, demonstrate a proven track record and share data points if they wish to secure capital. Others talked about being laser focused on business quality, looking harder than ever at gross margins and recurring revenues and digging deeper into customer-level diligence for things like reordering patterns.

A FOCUS ON ESG

Despite the pressure on balance sheets, lenders have yet to loosen their focus on the environmental, social and governance (ESG) aspects of their investments, and our panelists at the Symposium discussed how ESG is a large and growing priority. Both sponsors and credit funds say lending partners (LPs) are still pushing them to be ESG-centric, and lenders continue to look for ways to use financial and other incentives to drive impact.

Outside of financial metrics, impact metrics are important to lenders. Even funds that are not classified as Article 9 under the Sustainable Finance Disclosures Regulation are looking closely at ESG indicators during due diligence and discussing them in-depth during investment committee meetings.

Across the market there is a clear focus on having defined quarterly impact metrics against which credit funds can report back to their LPs to demonstrate and follow the impact of their investments. Increasingly, this is seen as a critical element of driving return.

ANTICIPATED CHALLENGES

Moving through 2024, several challenges remain that will impact the demands for financing in health and life sciences. One of the biggest challenges is the lack of available venture capital for many biotech and MedTech companies that have yet to become earnings before interest, taxes, depreciation and amortization positive. That finance shortage has impacted chief marketing officers and other C-suite executives in the complex biologics value chain, meaning many businesses that service venture-backed companies are delaying projects and some platform businesses are becoming single-asset companies.

Another challenge is the current regulatory landscape, which has seen changes such as the introduction of drug pricing policies in the United States creating uncertainty for equity investors. With the pricing of pharmaceuticals less certain, the lending dynamics have changed for several subsectors where investors are craving additional clarity.

THE YEAR AHEAD

Looking at the next 12 to 18 months, the consensus at the Symposium was that the outlook may be bumpy but can quickly change for the better. While the lack of an initial public offering market continues to make it difficult for biotech companies to access cash, we are moving out of a period of economic uncertainty and many are hopeful that equity markets will rebound in 2024.

Likewise, lenders are increasingly willing to offer flexibility in the form of full payment-in-kind tranches where they have conviction, suggesting that private debt markets are finding creative ways to support companies.

There is hope that defaults will remain low throughout 2024 and a recognition that, while deals are available, they may take longer to get done and diligence will be thorough. Long term, strong conviction remains around the growth fundamentals in the health and life sciences industries as well as around the potential for technology to overcome many of the structural issues that undermine the delivery of healthcare. Thus, the return of more buoyant deal activity cannot be far off.

What's clear is that relationships were prioritized in 2023 and will remain the focus in 2024 as lenders look to build productive two-way partnerships with management teams and sponsors to navigate balance sheet challenges.

The biggest takeaway from the Symposium was that health and life sciences borrowers are better positioned than many in other industries when it comes to accessing the credit markets – and for the right deals there is still plenty of capital available. Companies should continue to expect an appropriate level of scrutiny from lenders throughout 2024, but we predict the finance markets will continue to unlock throughout the year.

KEY TAKEAWAYS

- Last year, top-tier assets and quality borrowers were prioritized.
- Cash-strapped biotechs had to turn to Big Pharma for liquidity.
- Lenders are more focused than ever on downside risk and business quality.
- A focus on ESG and impact remains key.
- There is a lack of available capital for growth businesses.
- The current regulatory landscape is difficult to navigate.
- Creative lenders are likely to continue unlocking financing options through 2024

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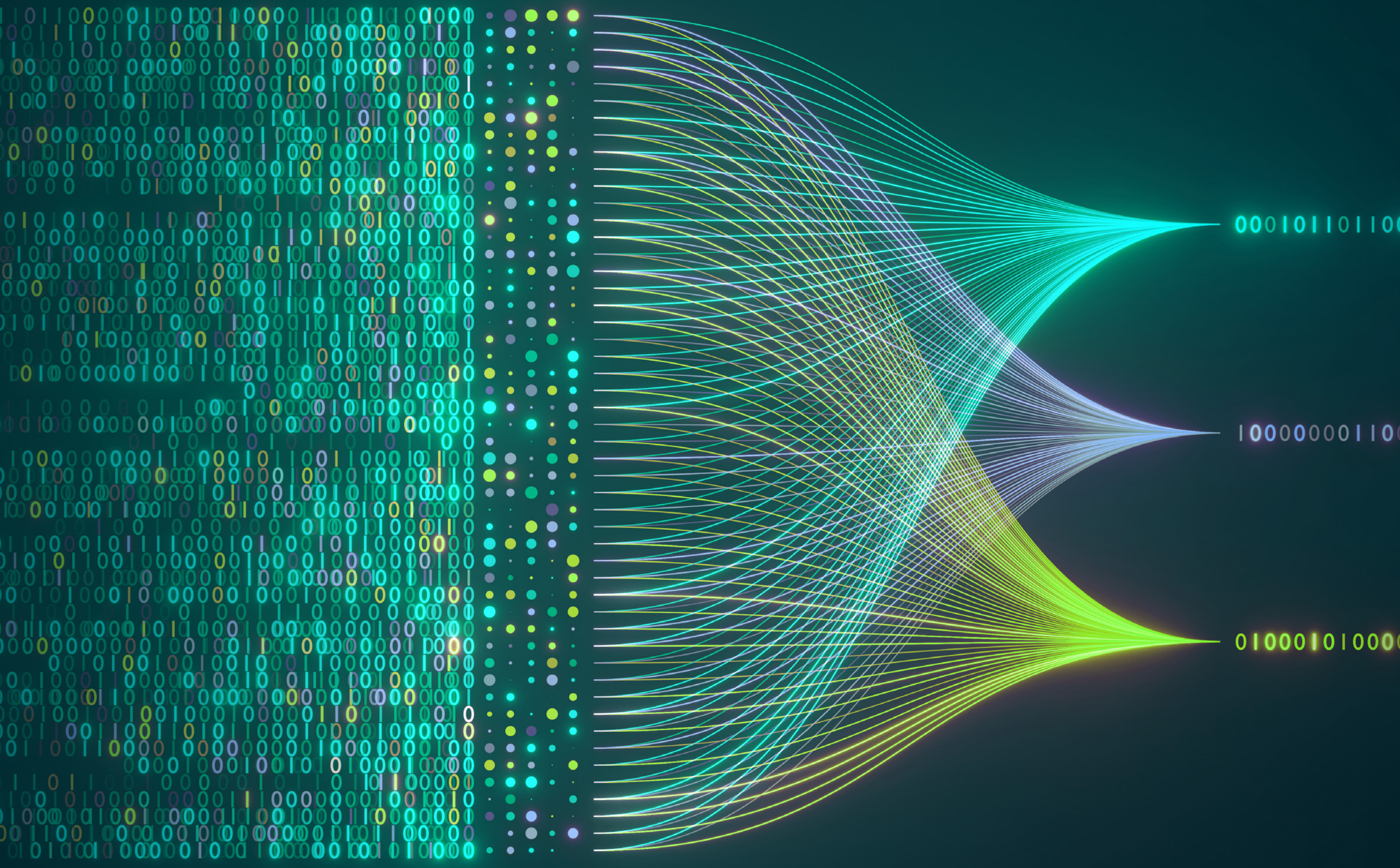
UNITED KINGDOM / FRANCE / BELGIUM

THE EU AI ACT: ENFORCEMENT INSIGHTS AND GUIDANCE FOR BUSINESSES

Lorraine Maisnier-Boché, Pilar Arzuaga and Simon Mortier



The EU Artificial Intelligence Act (AI Act) introduces a groundbreaking framework for regulating artificial intelligence (AI) across Europe, categorizing AI systems into four risk levels: prohibited AI, high-risk AI, limited risk AI and minimal risk AI. Each category demands specific compliance measures, impacting various sectors such as healthcare, finance and consumer technologies.

The AI Act's broad scope adds complexity to its enforcement, handled primarily by national market surveillance authorities within the EU Member States and supported by the newly established European AI Office for overseeing general-purpose AI models. Competences may overlap in some cases, and EU Member States have the discretion to designate one or several competent authorities.

The AI Act, expected to take effect August 2, 2024, mandates Member States to appoint their market surveillance authorities within a year. Businesses should engage with relevant authorities to ensure compliance and mitigate risks. Participation in the AI Pact, a voluntary initiative by the European Commission, is recommended for businesses to anticipate compliance requirements and showcase leadership in ethical AI governance.

This article aims to clarify the AI Act's enforcement mechanisms, detailing the roles of authorities at Member State and EU levels, and guide businesses through the regulatory landscape. It also highlights why businesses must understand their obligations under the AI Act and shares how to prepare for compliance.

Determining which existing national authority will assume the role of market surveillance authority is crucial.

MEMBER STATE LEVEL

National Market Surveillance Authorities and AI Systems

The AI Act builds upon the existing EU general framework for market surveillance of manufactured products (excluding food, feed, medicinal products, plants and animals, and products of human origin that are subject to specific market surveillance regulations) under Regulation (EU) 2019/1020.

Each Member State must appoint at least one national market surveillance authority that will be responsible for overseeing the application and implementation of the AI Act and conducting market surveillance activities for almost all AI systems. Moreover, to improve organizational effectiveness across the Member States, each one must designate a market surveillance authority as a single point of contact for the public and for coordination with their counterparts at Member State and Union levels.

Determining which existing national authority will assume the role of market surveillance authority is crucial. It's probable that multiple authorities could be designated per Member State, especially when AI systems are specific to a sector already under a regulatory authority's supervision (e.g., medical devices). For EU institutions, the AI Act has already designated the European Data Protection Supervisor (EDPS) as the competent authority.

Like any market surveillance authority under Regulation (EU) 2019/1020, national authorities will have the power to request corrective measures and impose administrative fines. Fines for noncompliance with AI regulations are tiered, reaching up to 7% of global annual turnover or €35 million for prohibited AI violations, up to 3% or €15 million for other infringements, and up to 1.5% or €7.5 million for providing incorrect information – whichever is higher. For small- and medium-sized enterprises and startups the rule is to go with whichever is lower. The European Commission will issue guidelines to help Member States align their national rules and practices.

Notifying Authorities and AI Conformity Assessment Bodies

Given the complexity of high-risk AI systems, the AI Act establishes conformity assessments for systems that involve third-party conformity assessment bodies, also known as notified bodies. These bodies carry out third-party conformity assessment activities, including testing, certification and inspection.

The Member States must designate notifying authorities that will be responsible for setting up and implementing procedures for the assessment, designation, notification and monitoring of these conformity assessment bodies. These procedures should be developed in collaboration with the notifying authorities across the Member States. Additionally, Member States have the option to delegate the assessment and monitoring roles to a national accreditation body.

The notifying authorities must organize their operational frameworks to ensure there are no conflicts of interest with conformity assessment bodies, maintaining objectivity and impartiality of their activities. Individuals who decide on the notification of conformity assessment bodies should not be involved in evaluating these bodies.

Furthermore, notifying authorities are prohibited from engaging in the provision of activities or consultancy services – like those rendered by conformity assessment bodies – on a commercial or competitive basis. They are also required to guarantee the confidentiality of information and to staff their operations with individuals who possess the necessary competence, including expertise in information technologies, AI, legal standards and the oversight of fundamental rights.

EU LEVEL

AI Office: The Center of AI Expertise for General-Purpose AI Models

Established January 24, 2024, before the AI Act's adoption, the AI Office is set to play a key role in shaping AI policy at the EU level. Its wide-ranging mandate includes coordinating EU stakeholders; aiding market surveillance authorities across Member States; and developing AI-related tools, methodologies, guidance and codes of practice. More specifically, the AI Office is tasked with enhancing EU expertise and capabilities in the field of AI and serving as a bridge to the scientific community.

The AI Office will also hold a more specific responsibility of overseeing the enforcement of rules related to general-purpose AI models. While national market surveillance authorities are responsible for supervising AI systems, the AI Office is primarily in charge of general-purpose AI models. It will have the authority to request information and documentation, evaluate these models and investigate potential rule violations, including gathering complaints and alerts.

A scientific panel of independent experts will assist the AI Office's monitoring activities by providing alerts when a general-purpose AI model is suspected of posing a concrete and identifiable risk at the Union level, or if it potentially meets the criteria for a model with systemic risk. These alerts are designed to trigger further investigative actions.

Should the evaluation process reveal serious and substantiated systemic risk concerns at the EU level, the European Commission can require providers to implement mitigation measures. These measures may include limiting the market availability of the implicated AI model through withdrawal or recall. Additionally, the European Commission can impose fines on general-purpose AI model providers that do not exceed 3% of their total worldwide turnover in the preceding financial year or €15 million, whichever is higher.

AI Board: An Advisory Body

In addition to the EDPS and the European Commission, an AI Board will be established and comprise of national authorities selected by each Member State that will represent their interests. Similar to the European Data Protection Board's (EDPB) role in the enforcement of the General Data Protection Regulation, the AI Board will serve an advisory and harmonization function. It will provide guidance on the AI Act's uniform implementation, issue recommendations and opinions (particularly concerning high-risk AI systems), facilitate coordination between national authorities and promote standardization efforts.

The AI Office is tasked with enhancing EU expertise and capabilities in the field of AI and serving as a bridge to the scientific community.

AI ACT: REGULATORY FRAMEWORK OVERVIEW

The above information can be summarized as follows:

MEMBER STATE LEVEL	
MARKET SURVEILLANCE AUTHORITIES	**NOTIFYING AUTHORITIES**
• At least one per Member State • Evaluates and oversees AI systems with direct enforcement powers • One market surveillance authority must act as a single point of contact	• At least one per Member State • Evaluates and oversees AI conformity assessment bodies

EU LEVEL	
AI OFFICE	**AI BOARD**
• Functions as an office within the European Commission • Serves as the center of AI expertise • Evaluates and oversees general-purpose AI models with direct enforcement powers	• Comprises one representative from each Member State, plus the EDPS and the European Commission • Provides harmonized guidance and opinions but does not have direct enforcement powers • Acts similarly to the EDPB for AI

THE INTERPLAY BETWEEN COMPETENT EU AND NATIONAL AUTHORITIES

To prevent overlapping competences and ensure the coordinated regulation of general-purpose AI models and their associated systems, the AI Act encourages cooperation and the exchanging of competences between national market surveillance authorities and the AI Office.

For example, market surveillance authorities must cooperate with the AI Office to carry out evaluations of compliance when a general-purpose AI system is directly used by deployers in a way that is considered high-risk. Similarly, market surveillance authorities may seek assistance from the AI Office if they are unable to complete an investigation of a high-risk AI system because of a lack of access to certain information about the general-purpose AI model on which the high-risk system is built.

In cases where an AI system employs a general-purpose AI model from the same provider, the AI Office takes on oversight responsibilities and assumes enforcement capabilities typical of a market surveillance authority.

The AI Act encourages cooperation and the exchanging of competences between national market surveillance authorities and the AI Office.

CONCLUSION AND NEXT STEPS FOR BUSINESSES

Identifying the competent EU or national authority for enforcing and overseeing the AI Act is crucial for ensuring regulatory compliance, obtaining guidance, managing risks and promoting innovation. Engaging with the relevant authority and adhering to its guidelines can help prevent legal and financial consequences, earn user trust and unlock new market opportunities.

To accurately identify the relevant authority, businesses should conduct a thorough assessment of their AI systems and models. This evaluation should categorize the systems and models based on their characteristics, risk level, application area and geographical deployment.

The AI Act still needs to be endorsed by the European Council and published in the Official Journal of the European Union before it can take effect, which is expected in May 2024. The Member States will then have one year to appoint market surveillance authorities and designate a specific authority as the single point of contact.

Additionally, businesses should be aware of the European Commission's AI Pact. It encourages organizations to voluntarily share their internal guidelines, processes and the specific actions they have undertaken to meet the AI Act's requirements, as well as test their solutions within the community. Participating in such voluntary commitments to comply with the AI Act's requirements before the deadlines can position organizations as leaders in ethical AI usage and governance and enhance their future interactions and relationships with EU or national authorities.

KEY TAKEAWAYS

- The AI Act will be enforced by national market surveillance authorities and the AI Office.
- Each Member State must appoint their market surveillance authorities within a year and designate notifying authorities to evaluate and oversee AI conformity assessment bodies.
- At the EU level, the AI Office serves as the center of AI expertise.
- The AI Office evaluates and oversees general purpose AI models with direct enforcement powers.
- The AI Board comprises representatives from each Member State who will provide guidance and opinions.
- Businesses should be aware of the AI Pact, which encourages the sharing of internal guidelines, processes and actions being implemented in preparation of the AI Act.

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UNITED KINGDOM / UNITED STATES / GERMANY / FRANCE

CROSS-BORDER RESTRUCTURING AND THE YEAR AHEAD

Aymen Mahmoud, Felicia Gerber Perlman, Jonathan Levine,
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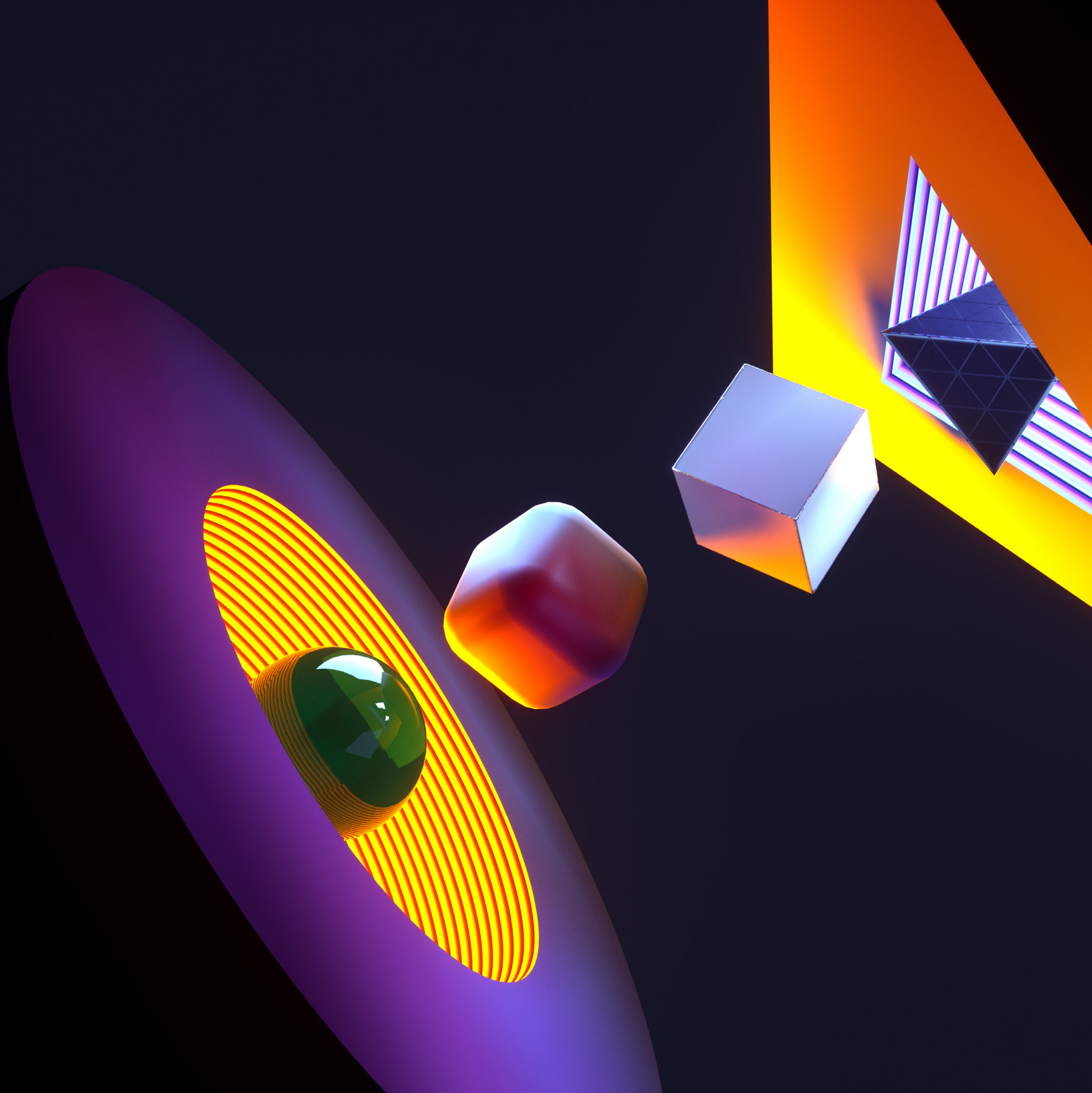
For the last few years, the guesswork surrounding the cross-border restructuring landscape has been no different from that surrounding the deal market or even the macroeconomic landscape. Peppered with a global pandemic, regional conflict and resulting uncertainty, few (if any) have been able to gaze with meaningful accuracy into their crystal ball. Most have moved to either provide more hedged predictions or identify wider trends.



FRANCE

Whether we can expect an influx of restructuring transactions this year largely depends on how we think about a “restructuring,” a word that has become more complex in its connotation. Now more than ever a restructuring is as much about liability management or driving increased equity value as it is about rationalising capital structures or reducing unwieldy leverage. It’s also about navigating the next 10 years as much as navigating the impact of the last three to five. It is not simply a negativity-targeting exercise. It’s about building business strength, maximizing value and returning efficient capital.

What is also clear is that, even in some of the premier international financial centers, the impact of macroeconomics combined with national and sectoral dynamics produces widely varying results. While this makes cross-border restructuring altogether more complex, it also needs to be more efficient than it was in the immediate aftermath of the recent global financial crisis.

Looking back at 2023, the restructuring market was relatively quiet despite some high-profile cases, such as the restructurings of supermarket group Casino Guichard-Perrachon and care homes group Orpea . Although mid-range apparel retailers have been heavily struck by the end of state financial support related to COVID-19, those businesses have not seen meaningful debt restructurings; only bankruptcy fire sales of assets could be organized as companies were wound up.

In 2024, we anticipate a much more active restructuring market based on three main trends, the first of which is balance sheet strengthening. A significant number of French businesses need to strengthen their equity capital position. As a result of the pandemic, many businesses suffered losses that were often not financed by shareholders but by state-backed COVID-19 loans. As equity capital positions are not strengthened, access to credit will be deeply limited, which may be debilitating for financings and refinancings. In the current economic context, this may lead to distressed situations for those French businesses.

The second trend is more macro-linked. Steady price inflation has weakened some sectors of the business-to-consumer economy, particularly the retail sector. The organic food and ethical clothing sectors specifically are suffering from the classic money-saving consumer strategy that is intended to preserve their standard of living (a key aspect of French culture that is potentially more limited in other geographies).

Thirdly, and somewhat predictably, certain sectors will be more drastically hit by rising interest rates. Economists estimate that real estate and infrastructure (both highly leveraged industries) are among the most exposed to this risk in France. In this respect, the French real estate sector is already in a troubled position: real estate agents, property developers and contractors are suffering from a decrease in the demand for office spaces and commercial premises, contributing to the rapid development of home offices and online shopping. Thus, we can expect major debt restructurings in these areas.

More complex restructurings within the French market are now anticipated. The past year has shown that the new accelerated safeguard process, which allows for cross-class cramdowns of creditors and shareholders, will be critical to implementing these restructurings in 2024 and beyond.

GERMANY

In 2023, the German economy faced strong headwinds marked by industry-specific vulnerabilities and repercussions from both the COVID-19 pandemic and the ongoing war in Ukraine. Thematic across other jurisdictions was the increased inflation rate and subsequent increased interest rates and energy costs. Each of these had a meaningful impact on German businesses.

We can expect refinancing German businesses to remain difficult and expensive in the near term.

Notably, the real estate, hospitality and retail sectors were among those to suffer the most from economic uncertainty. As government support measures were phased out, businesses that were already in stressed positions pre-pandemic found it increasingly difficult to sustain operations. This ushered in a rise in insolvencies as companies grappled with the economic realities.

At the start of 2024, a popular sentiment was that the German gross domestic product (GDP) would continue to decline along with global and eurozone GDPs, although each day appears to yield more positive market sentiment than the one before. It's unclear whether the high inflation rate will decline anytime soon. Therefore, it's very unlikely that interest rates will decrease significantly in 2024. As a result, we can expect refinancing German businesses to remain difficult and expensive in the near term.

The hospitality industry is also expected to continue facing adversity through increased energy costs, general price increases, the value added tax increase in Germany and a general decline in demand as individuals reduce their discretionary expenditures.

Similarly, the retail sector remains under pressure as traditional retail establishments in Germany and other countries continue to face difficulties adapting to changing consumer behaviors. The challenges posed by the pandemic-induced shift to online shopping, as well as the general decline in demand, resulted in a rise in insolvencies in the retail sector. We already saw the first filing for insolvency from a major German department store earlier this year.

It's anticipated that the real estate industry will be exposed to further depreciations of assets and will similarly be exposed to high refinancing costs relative to previous years.

As for the industrial sector, it will have to deal with high energy and labor costs as a result of wage and salary increases.

Given the overall economic situation in Germany, it seems likely the turbulent times for businesses will continue in 2024. Government policies and industry-specific support measures will play a crucial role in shaping the German insolvency landscape this year. Efforts to strengthen supply chains, boost consumer confidence and provide targeted assistance to struggling sectors will be decisive in fostering a more resilient and adaptive business environment, particularly as the expensive debt landscape appears here to stay.

UNITED STATES

As we move through 2024, it seems the Federal Reserve has achieved the soft landing it was aiming for: keeping inflation under control while avoiding a recession. Nonetheless, interest rates remain high and likely will for some time. High capital costs continue to challenge many US businesses that rely on leverage and borrowing for liquidity.

With the influx of private credit in the lending markets, it will be interesting to see how US lenders react to distressed situations or full-blown restructurings.

Combining these with the continued increase in the costs of goods and labor will, as in other jurisdictions, likely drive restructuring activity in the coming year. We expect an uptick in distress in technology-driven businesses, de-special purpose acquisition companies (SPACs), healthcare and commercial real estate, among others. This will provide opportunities for distressed investors with capital to deploy in a variety of liability management transactions.

We will likely continue to see a trend of pre-negotiated in-court restructurings this year. Parties will walk into court with agreements or full prepackaged bankruptcies in hand as a predictable bankruptcy process provides stakeholders with a good handle on the various restructuring outcomes and probabilities, making it easier to come to a resolution prior to initiating the court process, thus saving time and money.

Additionally, with respect to Section 363 (s363) asset sales, debtors will place high importance on having a fully baked stalking horse bidder on hand prior to entering bankruptcy. Unfortunately, 2023 demonstrated that entering a court-supervised s363 process poses far too many risks as a debtor's hopes of a going concern sale often turned into a liquidation plan or a conversion into a Chapter 7 case.

Finally, 2024 will bring some unknowns. With the influx of private credit in the lending markets, it will be interesting to see how US lenders react to distressed situations or full-blown restructurings. Will we see an increase in out-of-court workouts whereby private credit lenders will facilitate maturity extensions with sponsor concessions? Are private lenders going to consensually take the keys from borrowers by converting all or some of their debt into control stakes? Or will we see lender aggression following foreclosure on collateral?

Regardless, it will be an interesting year for the US restructuring market.

UNITED KINGDOM

Throughout 2023, the UK shared in many of the general themes seen in both Europe and the United States but with its own variances. For example, rather than the court-filing pregame approach that became popular in the US, the UK market has seen a more consensual approach to restructurings. In fact, restructuring as a tool now reflects a contractual arrangement between parties that does not require a formal process. As with many jurisdictions, these insolvency proceedings can be incredibly expensive and do not necessarily lead to a better outcome. Stakeholders in the UK have moved in this direction in the aftermath of the pandemic, buoyed by UK legislative changes that better facilitated going concern viability.

There's no question that macroeconomic indicators have been the same for the UK as they have for the US and the eurozone. Some would argue they were worse in the UK thanks to its recent political landscape and the subsequent impact on both currency and interest rates. While some sectors suffered following the pandemic, the impact appeared to have stabilized quickly for certain ones, such as hospitality and transportation. One sector that has struggled to regain its pre-pandemic shape is real estate, where the "return to work" dynamic has had varying influence on commercial landlords.

One key theme to look out for in 2024 is complexity. Liability management has become synonymous with restructurings, and the bespoke and detailed nature of these exercises requires significant legal and financial diligence. While a more cautious merger and acquisition (M&A) market has driven increased diligence and lengthy timelines, restructurings cannot afford that dynamic because time destroys value and liquidity needs may not give companies much breathing room. This will apply to both in- and out-of-court processes.

CONCLUSION

As we move through the second quarter of 2024, macroeconomic sentiment continues to improve on a global basis. Economic editorials detail an optimistic outlook based on low price-earnings ratios for a considerable number of European stocks and a very fair (if not unduly bearish) view on US stocks outside of the "magnificent seven" that enjoyed a fruitful 2023, leaving little estimation for downside.

M&A activity has increased in the last two quarters and will likely drive, at least, either moderate valuation increases or a more stable view on valuations to replace cautious inaction. This will provide businesses with an opportunity to move through periods of stress by being acquisitive (or by being acquired) and not just by optimizing capital structures. The weight of dry powder in both the equity and debt markets will undoubtedly support this, even if the era of ultra-cheap capital is behind us.

At the same time, data shows a far slower restructuring landscape over the last few years, giving rise to predictions that a build-up of activity will arrive like a broken water dam. This overlooks some key factors, however. Liability management exercises and out-of-court arrangements are not reported on and the nature of lending over the last seven years has been increasingly private. That is to say, just because we aren't reading about it doesn't mean it isn't happening. A "restructuring" today simply means something else because it now includes a very different subset of private transactions. It is almost certain that there is more to come.

Special thanks to Théophile Jomier and Fabian Appadoo for their contributions to this article.

KEY TAKEAWAYS

- Restructuring is a broad term that now covers liability management or driving increased equity value.
- Today's macro, national and sectoral dynamics are producing widely varying outcomes.
- Three trends are driving French restructuring in 2024: balance sheet strengthening, inflation and rising interest rates.
- We can expect more complex restructurings in France.
- In Germany, real estate, hospitality and retail have suffered the most from economic uncertainty.
- Refinancings in Germany remain difficult and expensive.
- Restructuring in the UK now reflects a contractual arrangement and does not require a formal process.
- Liability management exercises have become synonymous with restructuring in the UK.
- In the US, more distress is expected in tech businesses, de-SPACs, healthcare and commercial real estate.
- There will be more pre-negotiated in-court restructurings in the US this year.

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UNITED KINGDOM

PREPARING FOR THE FCA'S ANTI-GREENWASHING RULE

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The UK Financial Conduct Authority's (FCA) anti-greenwashing rule officially went into effect on May 31, 2024, covering all communications by FCA-authorized firms relating to products and services that reference environmental and/or social characteristics.

On April 23, 2024, the FCA published its finalized non-Handbook guidance, which is intended to help firms understand and comply with the new rule. The guidance considers feedback received in response to the FCA's consultation, which launched in November 2023, alongside its policy statement on Sustainability Disclosure Requirements (SDR) and investment labels.

BACKGROUND

In the financial services context, greenwashing can occur when investors are exposed to potentially misleading claims regarding the sustainability credentials and performance of products and services, increasing their exposure to regulatory intervention, claims for misselling and litigation. Tackling greenwashing has become a top priority for the FCA, and its introduction of the rule – as part of its broader SDR regime – will be key in strengthening its supervisory toolkit.

The final guidance is largely consistent with the FCA's initial proposals in its consultation guidance but additional details have been provided in several areas, including in the examples and the scope of application. Notably, the final guidance is consistent with existing regulatory expectations and is not intended to be a substitute for or override any other rules in the FCA Handbook.

THE ANTI-GREENWASHING RULE

The new rule in ESG 4.3.1R of the FCA Handbook has the broadest scope of the SDR rules and is the first rule to apply. It states that firms should "ensure that any reference they make to the sustainability characteristics of their financial products and services are consistent with the sustainability characteristics of the product of service and are fair, clear and not misleading."

The rule applies to all authorized firms, regardless of whether they are covered by other aspects of the SDR and regardless of the client categorization of UK investors. The rule also applies when a regulated firm communicates with clients in the United Kingdom in relation to a product or service or when it communicates a financial promotion (or approves a financial promotion for communication) to a person in the UK.

The guidance makes clear that the FCA expects sustainability references to be:

1 Correct and capable of being substantiated.

This principle could be violated by a firm overstating the sustainability characteristics of a product or service, or by a firm providing conflicting or contradictory information that does not give users a clear impression of the sustainability characteristics of a product.

For example, if a firm makes a statement that an investment fund is "fossil fuel free," it would be inconsistent with the rule if that fund's terms and conditions explained that it invested in companies involved in the production, sale and distribution of fossil fuels, even if those investments fell below a *de minimis* threshold.

Firms should regularly review their claims against the evidence collected to ensure the case for a claim is still correct on an ongoing basis. It's possible for a product or service to lose the sustainability characteristics it once had, therefore, regular compliance checks should be carried out. Where a claim makes specific reference to the evidence that supports it, a firm may want to consider whether it would be helpful to make that evidence publicly available in an easily accessible way.

2 Clear and presented in a way that can be understood.

Firms should ensure the intended audience for a product or service will generally understand the language used. This may require explaining technical terms and avoiding broad general terms that are vague or confusing.

Colors and imagery used in marketing or other materials can also be ambiguous or confusing and should not conflict with written representations on sustainability.

For example, it may be misleading if a firm uses an image of a rainforest with an overlay of text that reads "sustainable savings" on a webpage to advertise a range of savings products if only one of the products has sustainability characteristics.

3 Complete.

Claims should consider the full lifecycle of the product or service and should not omit or hide important information. Caveats that are applied to claims should be made clearly and prominently, and claims should be balanced so that negative impacts are not disguised or obfuscated.

For example, bonds are promoted, and claims are made about their sustainability impact. The bonds are used to finance a range of sustainability products including renewable energy. However, eligible activities also include products to improve the efficiency of fossil fuel energy production and distribution – information that was not included in the promotional materials. Omitting this information is potentially misleading, so the firm should be transparent in its marketing materials about what the eligible activities include.

4 Comparisons to other products or services should be fair and meaningful, allowing the intended audience to make informed choices.

For example, if a firm claims that by buying their investment bond investors will "reduce emissions" more than through buying other investment bonds on the market, the firm should make it clear how the comparison is being made or its limitations.

APPLICATION OF THE ANTI-GREENWASHING RULE

Although much of the rule is largely relevant to the asset management sector, it also applies to all regulated firms making any kind of claims about the sustainability characteristics of their product or service.

The final guidance provides a useful insight into the FCA's perspective on sustainability claims, with several examples included to demonstrate what the FCA considers compliant and deficient communications. The FCA has opted against providing a specific list of terms that would fall within the rule to avoid being unduly restrictive. However, this lack of specificity risks making compliance more difficult for firms as they will need to make their own assessment of what does and does not fall within scope.

On April 23, 2024, the FCA also published a consultation paper on extending the SDR and investment labels regime to include "portfolio management services" (CP24/8) with a deadline of June 14, 2024, to submit comments. CP24/8 mirrors the rules introduced in PS23/16 back in November 2023.

Claims should consider the full lifecycle of the product or service and should not omit or hide important information.

Portfolio management services are defined in CP24/8 as services provided to a client that comprise either managing investments or private equity or other private market activities that are either advising on investments or managing investments on a recurring or ongoing basis in connection with an arrangement, the predominant purpose of which is investment in unlisted securities.

CP24/8 makes clear that the FCA proposes to extend the SDR and labeling regime to include all forms of portfolio management services.

The SDR and labeling regime have been developed primarily for retail investors, although firms offering portfolio management services to professional clients or institutional investors can also opt into the labeling regime.

The naming and marketing rules for portfolio managers were proposed to apply on December 2, 2024 (if the offerings are aimed at a retail audience), alongside a requirement that portfolio managers produce consumer-facing disclosures if using a label or adopting sustainability-related terms without a label. Firms will need to start producing ongoing product-level disclosures starting one year later.

Firms with assets under management (AUM) greater than £50 billion will need to produce entity-level disclosures by December 2, 2025, and firms with AUM greater than £5 billion will need to start producing entity-level disclosures by December 2, 2026.

Asset managers who are not using labels but are using sustainability-related terms in their naming and marketing will not need to comply with the additional naming and marketing rules or produce the associated disclosures under the SDR and labeling regime until December 2, 2024. However, they must still comply with the anti-greenwashing rule as of May 31, 2024, and ensure their sustainability claims are fair, clear and not misleading or inconsistent with the sustainability characteristics of their products or services.

CONCLUSION

The FCA has made the direction of travel on regulating greenwashing and helping customers to navigate the sustainable investment market clear. Since the FCA is likely to be proactive in terms of enforcement (given its stated aim on these issues), firms will need to carefully consider their communications, procedures and policies to ensure they have robust controls in place and can meet any additional regulatory expectations resulting from the new rule.

KEY TAKEAWAYS

- The FCA's anti-greenwashing rule took effect on May 31, 2024, and covers communications by authorized firms referencing environmental or social characteristics.
- The FCA wants to crack down on greenwashing and help customers better navigate sustainable investments.
- The FCA has published guidance to help firms comply.
- Sustainability references need to be correct and capable of being substantiated, clear and easy to understand, complete and help investors make informed choices.
- The rules will be extended to cover portfolio management services.
- Firms need to carefully consider their communications, procedures and policies.

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