LEXOLOGY
Getting The Deal Through

Private Equity in the United Kingdom

2023 Edition

Private Equity in the United Kingdom

Dechert partnered with Lexology's *Getting the Deal Through* on their annual Market Intelligence Private Equity guide. The guide invites leading practitioners to reflect on evolving legal and regulatory landscapes and global trends in major jurisdictions around the world. Private equity experts from Dechert's Corporate, Financial Services and Tax practices in London provided the UK chapter content, which is in Q&A format and is reproduced below.

Please click here to access the full 2023 edition Market Intelligence Private Equity Guide.

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1. What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Jonathan Angell (JA): Private equity (PE) activity in the UK in 2021 was at its highest level since the 2008 global financial crisis. Whilst 2022 was slightly behind 2021, it remained comfortably ahead of pre-pandemic performance in 2018 and 2019. However, what could have been passed off as a 'slight bump in the road' in 2022 has continued into H1 2023, resulting in major 'roadworks' and 'traffic delays'. Having exhausted that analogy, it is fair to comment that 2023 has seen a significant decline in activity in the UK PE markets. For example, according to PitchBook data, mid-market deal volumes in the first six months of 2023 were down 35 percent on H1 2022 and 51 percent down on H1 2021. There appears to have been a modest improvement in European PE activity in Q2 2023 (and in early indications for Q3); however, it is difficult to detect any such uptick in the UK market – for now at any rate, the UK PE (and wider M&A) market seems stuck in the middle of the tunnel, with no discernible light at the end. This decrease in activity levels was seen across the board; however, perhaps inevitably, the drop-off in large-cap deals, and deals involving public markets, appears to be more significant than in the mid-market and private M&A. It is not difficult to identify the cause. PE sponsors are typically adept at adjusting quickly to the changing market landscape: so, for example, they (and the markets generally) circumnavigated the potentially choppy waters caused by the impact of Brexit and the pandemic, and even the invasion of Ukraine. However, geopolitical uncertainty retains the potential to disrupt activity further; and, in the UK, economic uncertainty has further eroded confidence and impacted deal volumes. Inflation remains stubbornly high in the UK, triggering rising interest rates and the cost of living crisis; and, perhaps significantly, many forecasts indicate that the UK is expected to recover more slowly than many other economies. This has had an impact on market liquidity and pricing and, more generally, on investor confidence. This fog of uncertainty (essentially, a concern as to whether things are at their lowest ebb, or whether things may continue to get worse before they get better) is undoubtedly affecting PE sponsors' appetite – and therefore activity levels. The ideal market conditions for dealmakers, including PE firms, are economic stability – it does not necessarily matter whether the market is up or down, merely stable – and that is not currently the case.

However, as a counter to that, it is undoubtedly the case that record amounts of 'dry powder' remain available to be deployed in the UK PE markets. It is also the case that the low number of PE exits in H1 2023 (continuing the trend in H2 2022) has built pressure. There will also be a UK general election by January 2025 (at the latest), and there are fears that there may be an increase in tax rates (whatever the outcome of the election). This may have a positive impact on deal flow in Q4 2023 and 2024 (as many businesses may decide they cannot wait before going to market). The combination of the above should mean that it is only a question of time before there is an uptick in activity generally, and an increase in confidence levels. It is also fair to note that, as always at times of depressed levels of activity, we are operating in a bifurcated market: there is still a competitive market for high-quality businesses, particularly those in 'hot' sectors (see further below for discussions on sectors).

Within that broader context, the PE market in the United Kingdom and, indeed, much of Europe and elsewhere, remains multi-layered. UK PE sponsors have historically operated very successfully across a range of sectors at all levels, from seed and venture capital funding to large (multi-billion pound sterling) PE transactions, including take-privates. For example, 2021 was the year of take-privates (five of the 10 biggest deals were public-to-privates) and of large-cap buyouts. 2022 and 2023 have undoubtedly seen a decrease in take-privates and large-cap deals – an inevitable consequence of the cyclical nature of transactional activity.

Historically, the United Kingdom has been the largest private equity market in Europe, with a long and proud history in welcoming private equity sponsors who are looking to fundraise and invest there. The UK also, therefore, has a well-established legal system and regulatory footprint to deal with various outcomes and challenges that the private equity industry may face from time to time. The UK PE industry has a strong and robust system and has created new asset classes and credit funds that have adapted to the leveraged buyout system.

2. Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?

JA: The most common types of PE transactions in the UK centre around leveraged buyouts (in the form of share and/or asset acquisitions), take-private transactions, refinancings, flotations and bolt-on transactions. Starting in 2021 and continuing through to H1 2023, we have noticed a marked increase in the number of bolt-on transactions – a low-risk strategy, which supports the growth of existing platform businesses. As a related point, we have seen financial sponsors continuing to back existing investments by moving them into new funds and continuation vehicles. KPMG's UK mid-market PE review reported that bolt-ons accounted for 67 percent of all PE deals in H1 2023 (noting that there were 219 bolt-on transactions in H1 2023, a 47 percent increase in volume compared to H1 2019).

We expect traditional PE sponsors will continue to seek innovative investment structures to allow the deployment of capital at attractive valuations, but with a greater degree of down-side protection (such as earn-outs, preferred equity or convertible debt).

In the past, the PE industry in the United Kingdom has adapted and driven value creation through its portfolio companies in highly focused and more innovative ways – and there is every reason to believe that it will continue to do so. This will undoubtedly give rise to conventional 'add-on' acquisitions, but also platform deals where PE sponsors rebrand an asset from the outset with a new management team. This will most commonly be achieved through carve-outs of entities from large corporates.

Pre-pandemic, PE firms started, and have continued, to establish long-term funds and/or deploy long-term capital. This extends the firm's period between its fundraising efforts and also changes its investment life cycle. Most obviously, this will assist with investments and assets that take longer to mature. It may also help change the perception of PE firms in the mind of some public shareholders, which may help PE firms to obtain shareholder approval on take privates.

Non-traditional PE funds (such as sovereign wealth funds, pension plans and family offices) have continued their shift from a minority position to a control or lead-investor-type role on direct investments in the PE space. This trend has been driven by the desire to have greater control, reduced fees and greater returns on invested capital, particularly in the traditional PE space. This shift in focus has, in turn, created additional competition for traditional PE funds. The result has been increased variation in the deployment of capital by these non-traditional PE investors across the capital structure.

Unsurprisingly, some sectors have been more attractive to PE investors than others: technology, media and telecommunications (TMT) and business services continue to be favourites (some reports indicate that up to two-thirds of PE activity in H1 2023 was in these sectors). Health care and financial services also performed strongly. This is in contrast to other sectors, such as: consumer markets (consumer products and services), where the cost of living crisis appears to be affecting investors' assessment of the value of consumer-facing businesses; and industrials, where supply chain and labour force issues, coupled with rising energy prices, have impacted levels of both demand and activity. Looking at sub-sectors, IT services and B2B appeared relatively resilient, in contrast to B2C.

Environmental, social and governance (ESG) considerations, including diversity and inclusion, are likely to remain a key focus, not least in terms of demand from limited partners, consumers and employees, and PE firms are taking a more proactive approach in the area. It is possibly fair to say that ESG is no longer considered a 'nice to have': every PE sponsor is mindful of ESG considerations when looking at opportunities.

3. What were the recent keynote deals? And what made them stand out?

JA: By way of example of some of the recent trends indicated above:

- Quantexa Limited, a PE-backed business providing decision intelligence solutions for the public and private sectors, completed a US$129 million series E funding round (led by GIC, but including a range of other PE investors such as Warburg Pincus, Dawn Capital and British Patient Capital). Quantexa is a British tech unicorn (with a valuation of US$1.8 billion); and

- Equistone's acquisition of a majority stake in Nexus Vehicle Rental, a leading B2B vehicle rental aggregator platform, from Phoenix Equity Partners, with debt facilities provided by Ares Funds.

4. Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? How are those challenges evolving?

JA: On the first issue, the answer depends, in large part, on the size of the deal. Venture capital investments and mid-market PE transactions tend to have a stronger UK nexus and are often either domestic UK or with limited cross-border involvement. Although somewhat a generalisation, a larger target company or business is more likely to have international operations (or plans) and therefore require cross-border expertise. In addition, many private equity funds are targeted at a specific jurisdiction or region. One trend in this respect, undoubtedly driven by investor appetite, but also by the ongoing challenge of deal origination and sourcing, is the proliferation of funds focused on different geographies (emerging markets being a prime example) and non-traditional PE areas (such as credit funds).

With regard to the second question, at its most basic, a cross-border element adds a layer of complexity. Multiple jurisdictions will almost certainly affect the tax structuring and add a layer of complexity to the debt and acquisition financing (both in terms of any debt push-down and security). The challenge is ensuring that this does not become a problem to the overall deal – either substantively or logistically. There is, simultaneously, a positive and a negative aspect to being a UK-based legal adviser. On the plus side, English law is (and, notwithstanding Brexit, continues to be) a significant 'export' of the UK, generating many cross-border transactions and opportunities. At the same time, the 'Anglo-Saxon deal methodology' that English legal advisers typically adopt may not be familiar (or universally welcome). Whether the transaction involves working with our non-UK offices across the globe or (in jurisdictions where we do not have an office) with independent law firms where we maintain good relationships, the objective is to identify any local law requirements quickly, and in a collaborative manner. These requirements can often be procedural or items of detail that are easily solved, but, if left to linger, can become more problematic.

5. What are some of the current trends in financing for private equity transactions? Have there been any notable developments in the availability or the terms of debt financing for buyers over the past year or so?

Philip Butler (PB) and ***David Miles (DM)***: With the dislocation in the high-yield market, the impact of rising inflation, quantitative tightening, increasing interest rates and supply chain issues coupled with increased energy prices and the geo-political issues that have arisen around the world, this has had a significant impact on PE deal flow generally but n that context private credit as a funding solution has become even more important for PE transactions, given the committed nature of the capital available, its continued availability at scale and the flexibility of the product with generally sole counterparty execution risk. This source of financing has been seen to fill the void in a number of instances to what would otherwise have been a high-yield or TLB solution, as well as having become a mainstay of funding for the PE mid-market.

For those transactions that are getting closed in the current environment, leverage levels have been reduced, day one equity cheques from PE sponsors have increased (as an overall percentage of the capital structure) and documentary terms and structures for lenders have improved. There has been a period of lender pushback in light of the tightened liquidity conditions – in particular in limiting add backs to EBITDA in relation to synergies and group initiatives.

Also the custom of the borrower 'designating' the lender counsel, which had become prevalent in the mid- and upper mid-markets, has seen some strong pushback from lenders following some high profile fallouts over the practice. It remains to be seen if this trend will continue in more buoyant market conditions.

ESG requirements have also become a feature of the market with more loans having ESG ratchet triggers contained within them, which is a feature being driven by some of the investors investing into private credit funds.

6. How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

Daniel Hawthorne (DH): From a tax perspective there continues to be an increased policy focus on transparency, disclosure and ensuring that businesses pay what is considered to be a fair amount of tax in the correct jurisdictions. In the United Kingdom, a number of recent legislative provisions have derived from a commitment to implement the recommendations of the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. In terms of the structure and financing of PE deal structures, both the anti-hybrid legislation (which seeks to counteract 'hybrid mismatches' arising from entities or instruments that are treated differently for tax purposes in different jurisdictions) and the interest barrier rules (that further limit the deductibility of corporate interest by reference to UK taxable earnings before interest, taxes, depreciation and amortisation) continue to influence typical structures. Further limitations on the availability of double tax treaty relief from withholding tax are another indicator of the direction of travel (whether by reason of the application of the 'principal purpose test' under the BEPS multilateral instrument or more robust beneficial ownership requirements established by EU courts in the 'Danish cases' and, in recent UK case law, *Hargeaves*). A further EU anti-tax avoidance directive, ATAD III (or the anti-shell directive), remains in the pipeline (potentially effective 1 January 2024) and will impact on European-based private equity structures using so called 'shell entities' if adopted.

From a private equity fund perspective, the positive recent introduction of the Qualified Asset Holding Company vehicle for alternative fund structures (to rival the intermediate investment vehicles commonly utilised in non-UK fund structures) signals a clear intention on the part of the government to improve the competitiveness of the UK as a jurisdiction in which to establish funds, and is hopefully only the first of a number of such positive measures.

Reform of corporate governance in the UK was kick-started by the UK government in late 2017 when it published a 'response' setting out 12 reforms that the government intends to make to the UK corporate governance regime. Areas to be reformed include, for example:

- Addressing significant shareholder dissent on executive pay;
- Broadening the role of remuneration committees;
- Use of long-term incentive plans;
- Encouraging investors to make full use of their existing powers on executive remuneration;
- Improving directors' understanding of the 'enlightened shareholder value' model; and
- Improving transparency.

These reforms have been implemented in large part since their announcement by various bodies, from government to HM Revenue & Customs, the Financial Reporting Council and, for the asset management industry, by the Investment Association, which published its Good Stewardship Guide in February 2021.

More recently, in May 2022, the UK government published a response to its 2021 consultation on restoring trust in audit and corporate governance in the UK. The response proposes various reforms, including in relation to corporate reporting, the accountability of company directors and the scope and purpose of audits. It is expected that these changes will be introduced over the next few years.

With respect to the financial services industry, including fund management, wide-ranging reforms will take place following the enactment in April last year of the Financial Services Act (FSA) 2021. A number of its provisions are in force as at of August 2022, but it will only be in the coming few years that the full set of comprehensive changes and reforms will be felt by the fund management industry.

7. What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?

JA: The typical public view (stoked by some politicians, trade unions and the like) is still that PE generates significant returns for the wealthy at the expense of other stakeholders in the businesses in which they invest. The boom in acquisitions by non-UK PE firms has also generated commentary to the effect that PE is draining UK businesses – the returns generated are flowing out of the country, to international investors, and leaving the UK. The UK PE industry, supported by the British Private Equity & Venture Capital Association and Invest Europe, has, over a period of time, presented a more complete picture.

Shareholder activism has steadily increased in the UK public markets. ESG is a crucial factor in this regard. On the plus side, activist shareholders taking positions in UK-listed companies may drive corporate break-ups, creating carve-out or acquisition opportunities for PE firms. There are, however, limits. For example, in a recent case, the court refused to allow Client Earth to proceed with a derivative claim against the directors of Shell plc for alleged breaches of duty (relating to alleged mismanagement of climate change risk).

8. What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

JA: There was a slight recovery in exit volumes in 2021, but there has since been a material drop-off in PE exits during 2022 which has continued in H1 2023.

In 2022 and H1 2023, given the uncertain capital markets and the pull-back by trade acquirers, there has been a significant increase in consolidation (assets being moved into new funds and continuation vehicles) and secondary buyouts, with some reports indicating that secondary buyouts have been the primary exit route in this period. The highest proportion of exits were in business services, whereas consumer goods and services have fallen – reflecting the current volatility in that sector. There remains a distinct lack of interest or enthusiasm in exits by way of IPO (Lotus Technology's SPAC transaction being an obvious exception). Most exits have been to strategic buyers, perhaps sensing an opportunity with falling valuations.

9. Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

Claire Bentley (CB): As forecast last year, fundraising levels began declining from the start of H2 2022 as global macro-economic uncertainties and geopolitical tensions continued and central banks began raising interest rates

in response to rising inflation. This has continued during H1 2023, which saw global private capital fundraising fall to US$517 billion, 35 percent lower when compared with the same period in 2022, according to Bain & Co's midyear report. More striking than this, *Private Equity International* (PEI) reports that the number of funds holding final closes during the first half of the year has fallen by nearly 50 percent from H1 2022 levels, demonstrating not only the reduction in LP capital available as a result of the denominator effect and a more cautious sentiment, but also investor preference for allocating what capital is available to larger brand-name funds and limiting their number of GP relationships.

In light of this, we are seeing an increasingly LP-favourable market and, other than larger sponsors or those with the strongest track records, which are generally able to hold their ground, the majority of GPs are having to offer greater fee discounts and concessions on terms than in prior years. We are also seeing an increasing number of sponsors offering more bespoke, tailored solutions to their most important investors in the form of separately managed accounts or funds-of-one. In addition, sponsors need to demonstrate that they have a strong enough bench to offer a compelling strategy to investors in the light of global macro-economic uncertainties and geopolitical tensions. The largest global sponsors are likely to have the bench strength as are niche sponsors of stressed or distressed strategies, but that will still leave many sponsors unable to raise new funds during H2 2023 and into 2024.

Last year, we commented on three noticeable trends: secondaries transactions (particularly GP-led secondaries); 'retailisation' of private funds and ESG investing.

As an update:

- Secondaries transactions in 2022 remained strong. According to Evercore data, transaction volume totalled US$103 billion in 2022, which, whilst down from 2021, still represents the second-largest year on record. In addition, despite the generally slower fundraising market across other private fund asset classes, industry expectations are that secondaries funds will continue to experience strong fundraising results with forecasts on average predicting around US$100 billion being raised in 2023 in anticipation of an uptick in deal activity. As noted last year, and as continues to be the case, the balance between LP stakes and GP-leds has shifted somewhat in favour of LP stakes and we expect this to continue.

- 'Retailisation' continues to be high on the agenda, with more sponsors seeking to find ways to access retail and semi-retail investors. In the EU, the EU ELTIF Regulation has been revised, with ELTIF 2.0 coming into force in January 2024, with changes such as making it easier for retail investors to access ELTIFs by removing minimum investment requirements and limitations on aggregate investments. In the UK, we have seen modest interest in the UK Long-Term Asset Fund, but no real interest in using the UK Long-Term Investment Fund (LTIF). The UK government is not proposing to make amendments to the UK LTIF regulation and, in fact, has announced that it plans to repeal the onshored UK LTIF, thus removing any potential UK domiciled alternative to the EU ELTIF.

- ESG: As we noted last year, and as more and more private funds upgrade from Article 6 to Article 8 or 9 funds, there remain concerns among market participants and regulators of 'greenwashing'. On both sides of the Atlantic, firms have been accused by regulators of 'greenwashing' and exaggerating the ESG credentials of their funds. BNY Mellon was fined US$1.5 million for mis-statements and DWS (the asset management division of Deutsche) is facing investigations by the UK and German regulators for overstating the amount of assets under management that it deemed ESG-compliant.

10. Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

CB: There is really no such thing as a typical fundraising process and timeframes can vary dramatically.

Over the past 12 months, in light of the challenging fundraising environment, average timeframes for raising a fund seem to have been increasing as compared to more recent years. Whilst the final closing deadline is still typically set at 12-18 months following the first closing, it is more common to see extensions beyond the headline term, either through extension mechanics exercisable at the GP's discretion pre-baked into the documents, or LP consent.

The key fundamentals of a successful fundraising remain the same: keep close to your investors and consider and respond to their requests; use a fund structure, jurisdiction and terms that are familiar and acceptable to your investors; and present your investors with a great pipeline of deals. In a challenging fundraising environment, if one is looking for a speedy fundraising, it is likely to be easier to close successor funds with existing limited partners, rather than target new strategies with new investors.

Having said this, there are basic steps all sponsors need to consider when launching a fund. The first question centres on when the right time is to fundraise:

- Are there restrictions in existing fund documents that prevent you from raising a new fund?
- Where are you in deploying the committed capital you still have?
- Are you coming into the market off a good (or great) exit track record?
- What will your investors think about capacity issues if you focus on a fundraising, leaving aside successor fund restrictions?
- For sponsors managing multiple funds with overlapping strategies, as is often the case for private credit managers, for example, do you need to prioritise certain funds over others if they will target the same pool of investors?

Once the client has decided that the time is right, we typically work with them on a teaser with key outline terms and a fund structure or, in certain circumstances, a more fully developed term sheet. The structure will have been tested and discussed from a commercial, legal, regulatory and tax perspective, to make sure that it appeals to the target investor base, but does not involve an unnecessary level of regulation, complexity and cost. The nuances inherent in that analysis have changed in the past few years, but, as before, the aim is to have a structure that fits both sponsors and investors, taking into account evolving regulatory challenges, as well as the rapidly changing international tax regimes and best practices.

Testing the market may take two weeks, two months or more. Once the sponsor has identified its cornerstone investors, or otherwise gained some traction, we then move to full-form documentation. If there is a regulatory approval process, then that will drive the timetable; if not, then we work with the sponsor and service providers to get draft documentation into a data room as quickly as is sensibly possible.

The next key step is investor negotiations. Principal-to-principal discussions normally precede our re-engagement in the process, but we then focus on agreeing amendments to constitutional documents – typically a limited partnership agreement – to the extent required or on negotiating side letter terms. Investors increasingly have a list of points that they focus on (the Institutional Limited Partners Association has done a good job of framing some

of these discussions) and large investors tend to have their preferred form of side letter. The points usually break down into:

- Commercial points (for example, key man or economic terms, restrictions around post-investment period drawdowns or recycling, LP advisory committee seats);
- Regulatory points (for example, restrictions on certain types of investment and corresponding excuse rights);
- Tax points (for example, ensuring that there is adequate tax reporting and compliance); and
- Internal LP-specific points (for example, transfer rights, confidentiality or other policy requirements).

We are frequently seeing relatively detailed negotiations, with one or two cornerstone investors, before other first-close investors engage, particularly where those cornerstone investors are known in the market to be prepared to test terms. We are also seeing an increasing use of the 'strategic limited partner' concept to attract investors who are not just large investors but who are seen by the sponsor as bringing an expert perspective or other strategic value to the table. Where you have strategic limited partners, it is important to pay attention to the most-favoured nation clause in your side letter, since the strategic limited partner concessions, which often include more favourable economic terms, co-investment rights etc., will be bespoke and should not be available to the wider LP-base.

In terms of governing law, due to Brexit, but also other regulatory and tax considerations, for example, access to the EEA marketing passport under AIFMD, UK fund managers often choose to domicile their funds in EEA jurisdictions such as Luxembourg or Ireland. It might be required, or simply more appropriate, to subject certain agreements or constitutional documents to the local foreign law, while the management or advisory agreements as well as deal documentation often remain governed by English law, particularly where UK-domiciled entities are party to such documents. Such choice of law clauses specifying English law as the governing law of contractual and non-contractual obligations should continue to be recognised by EU courts, based on Rome I and Rome II EU Regulations. In the UK, the necessary corresponding legislation was passed in March 2019, ensuring that substantially the same rules will continue to apply in the UK in relation to the choice of foreign law.

11. How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

Colin Sharpsmith (CS): The FCA has recently been reviewing its approach to supervising the asset management sector, including PE and other fund sponsors.

PE sponsors located in the UK are typically regulated by the UK Financial Conduct Authority (FCA) as either investment managers with permission to carry on discretionary portfolio management (and there are a couple of types of licence depending on size of funds, the investment strategy and whether there is another management entity in the fund structure) or non-discretionary investment advisers (who give investment recommendations to the fund manager).

The rules of the FCA, which frame the conduct of PE (and other) sponsors, are currently still based on EU legislation, but are undergoing review as part of the so-called Edinburgh reforms as the UK looks to diverge following Brexit. The FCA has, historically, taken a pragmatic approach to implementation of those provisions, such as making it easy to register funds for marketing in the UK or permitting application of proportionality principles to remuneration rules. The Financial Services and Markets Act 2023 received the Royal Assent on 29 June 2023, giving the FCA wide powers to replace existing rules that were retained at the time the UK left the EU. The FCA is currently engaging in wide-reaching consultations with the asset management sector and the next few years will

see significant changes to existing UK financial services regulations as well new laws and regulations coming into effect that will impact the fund management industry as a whole, including private fund managers and sponsors.

Among the most significant new rules introduced in 2023 for fund distributors in the UK is the new FCA Consumer Duty. The Consumer Duty applies from 31 July 2023 (UK firms have been required to take steps to implement measures so that they are able to satisfy the Consumer Duty from this date). In relation to PE funds, the Consumer Duty applies to any funds where the minimum subscription is less than £50,000 and which are not restricted to professional investors. UK distributors which are subject to the Consumer Duty have been liaising with fund sponsors (including those based overseas) to ensure that they have sufficient information in order to be able to comply with their obligations.

Regulators remain acutely wary of the misuse of crypto assets. In June 2022, HM Treasury published the outcome of and proposed response to its 2021 consultation on the proposed amendments to the UK Money Laundering Regulations 2017. Following approval by Parliament, the amendments came into force on 1 September 2022. There are a number of proposals related to “Virtual Asset Service Providers”, which are required to be registered with the FCA for the purposes of anti-money laundering supervision.

In addition, in June 2023 the FCA introduced new rules for the making of financial promotions regarding crypto assets. These are expected to take effect from October 2023.

12. What effect has the AIFMD had or will it have on fundraising in your jurisdiction?

CS: Inconsistencies in the manner in which AIFMD was implemented by EU countries in terms of the interpretation of ‘pre-marketing’, ‘marketing’ and the regulatory notification processes have been harmonised through the Cross-Border Distribution of Collective Investment Undertakings Directive (Directive (EU) 2019/1160) and the Regulation on facilitating Cross-Border Distribution of Collective Investment Undertakings Regulation (Regulation (EU) 2019/1156) (collectively, the “CBD/R”). The UK has not adopted the CBD/R as UK law and nothing in the Financial Services Act 2021 refers to the CBD/R. Accordingly, now that the UK is a third country for the purposes of the AIFMD, UK managers will be in the same position as managers from other third countries such as the U.S., Singapore or Japan. Marketing to EU investors will need to be made on the basis of the National Private Placement Regimes (NPPR) of EU countries under article 42 of the AIFMD, where this has been implemented. It should be noted that several EU countries, including Italy, France and Spain, do not have in place systems to permit private placement of a fund managed by a third country manager.

A pre-condition to accessing the NPPR under article 42 is that there is a cooperation agreement in place between the UK and the relevant EU 27 member states. On 1 January 2021, several memoranda of understanding came into effect, including a multilateral memorandum of understanding between the FCA and EU and EEA National Competent Authorities covering, among others, investment services and asset management activities. Accordingly, UK managers can raise funds from EU/EEA investors on the basis of an article 42 private placement, albeit with certain changes likely to come about due to the CBD/R. For example, the CBD/R contains a recital that states that national rules cannot disadvantage EEA AIFMs as compared to non-EEA AIFMs. As a result, a number of EU countries have introduced some form of ‘levelling-up’ of their NPPRs to bring them in-line with the CBD/R rules on pre-marketing and discontinuation of marketing.

Whenever looking at marketing of funds managed by a third country (e.g. UK) manager, it is important to consider the location of any staff who will be conducting the marketing and whether they are treated as staff of the manager which will be registered for marketing under article 42, or if they will require some other regulatory cover to be put in place in order to permit them to carry on marketing activities on behalf of the manager.

13. What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

DH: Although it remains a politically divisive issue, as things stand, favourable capital gains tax treatment for carried interest remains available in the UK in certain circumstances, although a higher special rate of 28 percent applies to carried interest (as compared to the standard 20 percent rate for capital gains). In addition, consideration needs to be given to the 'income-based carried interest' regime that, broadly, looks to the weighted average investment holding period of fund investments in determining whether capital gains treatment should be available. An average investment holding period of at least 40 months is generally required for full capital gains tax treatment, with an average holding period of less than 36 months leading to full income tax treatment. These rules have introduced additional complexity and uncertainty for managers and have obviously restricted the range of funds in respect of which tax-efficient carried interest is available. There remains a real concern that favourable tax treatment for carried interest will be abolished (and the Labour party has indicated a clear intention to do so, should it come to power). Alternatively, it is possible that capital gains tax rates for carried interest (or more generally) may, at some point, be more closely aligned with income tax rates.

14. Looking ahead, what can we expect? What might be the main themes in the next 12 months for both private equity deal activity and fundraising?

JA: The current economic situation (with rising inflation and interest rates and a weak GBP) has undoubtedly replaced the covid-19 pandemic (which, in turn, had overtaken Brexit) as the key external influence on PE transactions in the UK. However, (successful) PE sponsors and investors have adjusted to this changing dynamic on several occasions and we expect that to continue.

ESG and DE&I will continue to be extremely important. We are seeing factors such as diversity, carbon footprint and regular ESG reporting become significant factors in assessing potential investment opportunities – very much as an automatic pre-requisite/standard hygiene matter, rather than a 'nice to have'.

Looking forward, on the plus side there remain the significant amounts of 'dry powder' available to PE funds. Sitting on an investment and waiting for markets to improve may be a necessary short-term measure, but it is not a particularly effective strategy for PE firms. The current slow-down in M&A activity has done nothing to ease the pressure – for both investment and exit activity – on PE sponsors. As a result, we anticipate an uptick in activity in Q4 2023 and into 2024 – whether driven by a market improvement, a degree of stability (and confidence) or concern about changes in tax rates following the upcoming general election.

Deal teams with the deep sector expertise required to understand the effects of these various factors on their target industry and the ability to execute transactions in distressed environments will be best placed to take advantage of the opportunities presented in the market.

Dechert’s Private Equity Practice

Overview

Dechert has been at the forefront of advising private equity firms for almost 40 years and ranked among the top law firms for U.S. and Global PE Buyouts, and Global M&A by *Bloomberg*, *Mergermarket* and *Refinitiv*. With more than 300 private equity and private investment clients, we have unique insights into how the industry has evolved and where it’s going next. Our globally integrated team of more than 350 private equity lawyers advises private equity, private credit and other alternative asset managers on flexible solutions at every phase of the investment life cycle.

Recent Transactions

Examples of recent private equity transactions on which Dechert advised include:

- **Court Square** on its acquisition of Edge Technology Group by its portfolio company Thrive.
- **Further Global Capital Management** on (i) the acquisition of a majority stake of Progeny, a leading professional advisory platform; and (ii) the acquisition of AA Ireland Limited.
- **GIC**, as part of a consortium on (i) the partial sale of a 4% stake in London Stock Exchange Group plc (LSEG) to Microsoft; and (ii) its share buyback by the LSEG.
- **GIC** on its investment in Quantexa, a global leader in decision intelligence solutions.
- **Graham Partners** on its acquisition of Taoglas Group Holdings Ltd., a global designer and manufacturer of advanced digital and connectivity products.
- **Metric Capital Partners** on its co-investment into the Soul Foods Group, a family-owned operator of franchise restaurants.
- **Mid Europa Partners** on its acquisition of Pigu and the combination of Pigu and Hobby Hall Group.
- **Quilvest Capital Partners** on its acquisition of a leading frozen food specialist and supplier.
- **Variant Equity Advisors** on its acquisition of the CompuCom Group, a global technology and digital solutions business.

Awards and Recognition

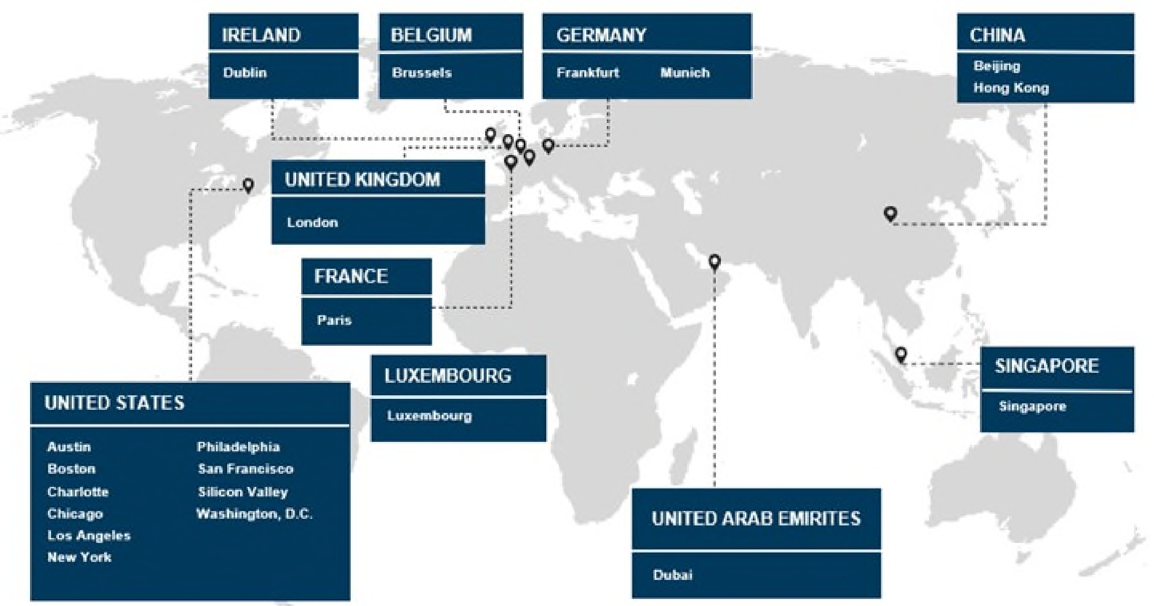
The Legal 500 United Kingdom	▪ Ranked as a leading firm in the United Kingdom for **Private Equity: Transactions, High-value Deals (£250m+)** (2024)
IFLR	▪ Ranked among the top law firms in the United Kingdom for **Private Equity** (2024)
Chambers Top Ranked Global 2023 Dechert LLP	▪ Ranked among the top law firms for **Private Equity Buyouts: Mid-Market** (2023)
Bloomberg® REFINITIV	▪ Ranked among the top law firms for **Global M&A, Deal Value and Deal Volume** (2023)
PitchBook	▪ Ranked among **the most active law firms for Private Equity Debt Deals** (2022)
The Private Equity Awards 2021 realdeals	▪ Winner “**Pan-European Legal Adviser of the Year**” (2021)

About Dechert

Dechert is a global law firm.

Dechert is a global law firm that advises asset managers, financial institutions and corporations on issues critical to managing their business and their capital – from high-stakes litigation to complex transactions and regulatory matters. We answer questions that seem unsolvable, develop deal structures that are new to the market and protect clients' rights in extreme situations. Our 1,000+ lawyers across 21 offices globally focus on the financial services, private equity, private credit, real estate, life sciences and technology sectors.

Dechert Around the World



Dechert's Private Equity Podcast Series

Hosted by members of Dechert's Private Equity practice, Committed Capital explores current issues and trends affecting PE globally, featuring conversations with leaders from across the industry.

For further information,
visit our website at dechert.com

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