Linklaters

Issues for Financial Sponsors and their portfolio companies

Staying agile to be ahead of the game

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Contents

1 Introduction

In a landscape shaped by geopolitical shifts, economic challenges, diverging societal and political views, and the swift advance of technology, agility and foresight are pivotal in steering a business to success.

The responsibilities of business leaders and corporate boards have expanded beyond traditional strategic oversight. Decision makers are now tasked with protecting digital frameworks from cyber threats, advocating for sustainable and responsible governance practices, and leading the charge in energy transition efforts. These are not just items on an agenda: they are strategic risks that need to be managed alongside regulatory demands and the expanding range of personal liabilities directors may encounter. Sponsors and their portfolio companies need to continue to review and adapt governance practices and operations to withstand these pressures. It's partly about resilience, but in this shifting landscape it's about being confident in your governance, legal and compliance structures and frameworks so that your organisation can be agile - with confidence - when it needs to be.

Our latest "Issues for Financial Sponsors and their portfolio companies" publication is a compendium of both emerging and perennial topics that we believe should spark lively discussion for decision makers over the next year. We offer focused and practical insights to aid you in planning for the challenges ahead. In this edition, we examine the governance challenges presented by the rise of generative AI and the intensifying issues in cyber security. We dissect the latest regulatory shifts that are reshaping mergers and acquisitions, map the latest twists in the path to a low carbon energy transition, and consider the way forward for diversity, equity, and inclusion (DEI) policies.

We would be delighted to support you as you navigate the hurdles ahead.

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At Linklaters, we provide thorough legal and regulatory analysis, insight into the expectations of regulators, and extensive knowledge across sectors and geographies. Beyond this, we bring expertise in risk consulting, compliance, and controls to proactively address our clients' most intricate risk-related issues worldwide.

2 Beyond the peak of inflated expectations: Using generative AI to enhance performance

One of the reasons for the success of the internet was its application to virtually every industry in making information or products available to customers and investors globally. In the same way, the open design of generative AI tools for anyone to create any form of text, image, code or video, at incredible speed, using natural language prompts, suggests that GenAI has huge potential.

All of our careers have been marked by constant technological change. As different waves of innovation arrive the trick is to determine which are hype, which are significant, and which are truly transformational. This exercise is carried out with hindsight. After all, in 2000 the internet was dismissed as a "passing fad".[1]

The hype cycle

The consultants, Gartner, track these technological changes through their hype cycle: from those that scale the 'Peak of Inflated Expectations' before plunging into the 'Trough of Disillusionment', to those that survive to climb the 'Slope of Enlightenment' to the 'Plateau of Productivity'.

For every technology that makes it to the Plateau of Productivity, many others fall by the wayside. Back in 2000, Gartner was tracking a range of other technologies (such as personal fuel cells, digital ink, head mounted displays and quantum computers) whose time is either yet to come or never will.

Generative AI has certainly had its fair share of hyperbolic predictions about its future impact over the last couple of years – "You can have a job if you want to have a job for personal satisfaction. But the AI will be able to do everything."[2]

> "Businesses must ensure that they keep up with the legal and regulatory requirements, including an assessment of their AI risks and how they will mitigate those risks via an effective control framework."

After the excitement of last year's piloting and exploration, we are now seeing some more critical assessments of the technology as projects start to highlight certain limitations and risks. There is no doubt AI is good at many things: selecting the right use cases for your business, identifying which ones will deliver value, and avoiding the pitfalls and risks are key issues to be considered if one is to benefit from its potential.

What is your strategic plan?

It's important to recognise that a transition through the 'Trough of Disillusionment' is an inevitable part of the technology lifecycle. It is impossible for GenAI to deliver all of the promises that people have made about it (and we may live to regret some of those that it does deliver). However, some things are already clear:

> Generative AI is very good at some things.

> Even if generative AI can't do the entirety of a task itself, it can greatly increase the productivity of your workforce with some tasks, such as coding, reporting and illustrating.

> The technology will get better. There will be improvements to the general models, but also the development of specialist AI models for specific tasks, which may deliver multiple smaller benefits rather than a single transformational change.

1 Internet *'may be just a passing fad as millions give up on it'*, Daily Mail, 5 December 2000.
2 Elon Musk in conversation with Rishi Sunak, November 2023.

Sponsors and portfolio companies will need a strategic plan that addresses the threats and opportunities of this new technology. While there may be opportunities to enhance services and generate new revenue streams, your plans may not deliver immediate pay-offs. It may instead follow a J-curve as the initial investment in redesigning business processes takes time to deliver a return in improving productivity and cost efficiency.

Why is AI office etiquette important?

An important issue to address is the incorporation of generative AI into standard office tools. This promises significant productivity improvements. For example, it will allow your workforce to be much more effective by:

> Spending much less time writing emails, presentations and reports.
> Transcribing video meetings and generating summaries and to do lists.

However, this technology needs to be introduced carefully. Our inboxes are already overloaded. Generating ever more emails – padded out with AI's own platitudes – will not help your business operate more efficiently. We all try to make video calls more bearable by introducing humour, but may not always see the funny side with AI automatically transcribing all those jokes for perpetuity on the office systems.

Equally there is a risk that a company's workforce no longer properly reads or understands the content that is generated for them. Emails and messaging platforms are now critical in both corporate governance and in litigation and regulatory investigation. The courts and regulators will be unsympathetic to claims that content was just generated by the AI, even though it perhaps doesn't accurately reflect the context of the human interactions, or the understanding and intentions of the people involved.

You will likely need to work out a new etiquette to ensure responsible and effective use of this new AI office technology. This should include guard rails: guidance on how and when the AI tools can be used, and when AI-generated materials should be subject to human review.

What about compliance and risk management?

Sitting behind these strategic considerations is the newly emerging legal framework. This consists of both:

> A growing body of specific AI laws, such as the EU AI Act, China's generative AI law and various US laws (particularly State laws on issues such as employment and biometrics). The effect of these laws varies but they will impose a significant new compliance burden on some businesses.
> Increasing enforcement of existing laws and regulations. For example, EU data protection regulators have launched a taskforce to investigate ChatGPT and the Italian regulator has (again) decided ChatGPT is in breach of the GDPR, while competition regulators are already raising concerns about the concentration of AI power in the hands of the big tech companies. Financial services AI regulations are already proliferating, and in the UK regulators are piloting a multilateral co-operation approach where the FCA, ICO, CMA and OFCOM are working together to create more future-proofed and holistic AI regulation.

These issues are likely to attract increasing regulatory focus as AI becomes more widely embedded in business and society. There is also likely to be more private litigation, as evidenced by the growing number of intellectual property disputes between the creative industries and AI providers. Businesses must ensure that they keep up with the legal and regulatory requirements, including an assessment of their AI risks and how they will mitigate those risks via an effective control framework. Legal and Compliance functions will need to react quickly in this fast developing environment.

"Sponsors and portfolio companies will need a strategic plan that addresses the threats and opportunities of this technology. While there may be opportunities to enhance services and generate new revenue streams, your plan may not deliver immediate pay-offs. It may instead follow a J-curve.."

Not forgetting the ethical considerations

Alongside the legal framework is the expectation that technology is rolled out within a clear ethical framework, consistent with your business's wider approach to ESG. Many of the laws in this area are principles-based so a broad ethical approach to new technologies is vital from both a reputational and legal perspective.

FIVE ISSUES FOR YOU TO CONSIDER

1. Do you have a strategic plan to maximise the benefit of AI? Does the plan include concrete steps to explore, pilot and deploy the technology across all its facets? Does it factor in the need for initial investment in business process change?
2. Does the plan instil appropriate governance so that business lines and technology teams are challenged to demonstrate that AI is the right solution to identified business needs and that the associated risks have been identified and mitigated?
3. Is the business thinking about the etiquette that should apply to the use of generative AI in office software? AI is already coming up against existing laws in areas such as intellectual property protection, employee and customer bias and product liability, so it is important that guard rails are applied from the outset.
4. Are you tracking new AI laws and enforcement of existing laws on AI products, particularly as they affect any portfolio company's key products in key jurisdictions? Markets where AI rules are developing fast include the EU, US, China and India.
5. Are you engaging with regulators? They are often eager to talk to key market stakeholders about their AI experiences, so it is a useful time to increase regulatory engagement to ensure you understand the direction of travel and can influence policy direction.

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FURTHER READING

> AI in financial services 3.0 Managing machines in an evolving legal landscape

> The LinksAI English law benchmark

3 Cyber attacks: Keeping pace with new governance expectations

The Bank of England's recent systemic risk survey[3] suggests that the risk of cyber attacks is greater than ever. It was the most common concern, with 80% of respondents identifying it as a systemic risk to the UK financial system, and 70% identifying it as the most challenging risk to manage.

Why is this a concern?

There has been rampant growth in extortion attacks. The industrialisation of the ransomware market has led to a significant increase in both the frequency and sophistication of attacks. The amounts of money at stake mean there are a large number of bad actors waiting to ruthlessly exploit any vulnerability in your systems. On acquisitions, the robustness of a target's cyber security continues to be a key focus and area of concern in the due diligence phase.

Sitting behind this is the risk of nation states launching a hot war in cyber space. The cyber warfare accompanying the war in Ukraine has remained localised so far; but there are other significant global geopolitical tensions. The plausible deniability of a cyber attack means that some nation state actors could see this as a low risk means of retaliation, even though it risks a damaging and destabilising escalation.

Why is governance a challenge?

Ensuring the right governance framework is in place is difficult. Cyber security is highly technical shrouded with its own jargon and culture. Very few board members can be expected to have a complete understanding of the technical details.

Added to that is the "randomness" of successful attacks. For sure, many attacks could have easily been prevented with hindsight – and some could have been avoided through foresight – but even the slightest crack in your defences can have catastrophic consequences. Even the best prepared companies can never rule out the risk they might get hacked.

So how can you get a clear picture of the cyber-preparedness of your organisation and portfolio companies, and be comfortable that it is, so far as possible, protected against cyber attacks?

> "Tabletop training cannot turn boards into cyber security experts but should equip them to ask if foundational protective measures are in place."

The right metrics

Board reporting is a powerful way to drive the right behaviours. Something that might previously have been dealt with in a relatively informal way – or not tracked at all – will likely have to be dealt with in a much more organised and systematic way once a reporting obligation is in place.

The key is to identify appropriate metrics and to interpret the resulting data correctly. For example, a board might impose a requirement to report identified vulnerabilities in the business's systems, alongside the means by which the vulnerability was identified and the average time to patch that vulnerability. This is valuable information for the board but a spike in vulnerabilities might not mean insecure practices, but be an indicator of better testing and detection.

3 *Systemic Risk Survey Results - 2023 H2*, Bank of England, 10 October 2023.

Training and "tabletops"

You might also want specific training on cyber security, and the particular risks faced by the business. Indeed, this will be a regulatory requirement for some EU businesses as a result of the new Network and Security Information Directive (NIS2) and Digital Operational Resilience Act (DORA).

Similarly, you might want to understand and attend tabletop exercises to simulate a cyber attack on the business and test its preparedness. For example, DORA has prescriptive detail on what firms should have in place with regards to ongoing testing and monitoring. Firms should be thinking about these issues and where appropriate leveraging their existing operational resilience controls.

The right questions

Tabletop training cannot turn boards into cyber security experts but should equip them to ask if foundational protective measures are in place. For example:

- **Testing and assurance:** Has any threat modelling taken place? Has penetration testing been carried out and, if so, how recently and how comprehensive is it? Has any external assurance been obtained about the business' cyber preparedness?
- **Vulnerability management:** How does the business identify vulnerabilities in its systems? How are system vulnerabilities identified and patched, and how is this process reported? Are vulnerabilities reported to the sponsor?
- **Defence in depth:** What measures have been taken to limit the effect of a successful attack? For example, what intrusion detection measures are in place? What has been done to limit privileged access to systems?
- **Supply chain:** What steps has the business taken to assess and mitigate cyber risk from its supply chain and other third parties?
- **Staff awareness and training:** What training has been given to staff on cyber security risks and, most importantly, what is the culture of the business? Does the 'tone from the top' emphasise the need for good cyber security?
- **And a question that often flushes out valuable information is:** If you were given an extra £500,000 budget for cyber defence, what would you spend it on and why?

New governance proposals aimed at defining best practice

These measures all need to sit within the right governance structures. The UK Government has consulted on a Cyber Governance Code of Practice to help define best practice in this area. An outline of the draft code is set out in the table opposite and it is likely to eventually form the baseline expectation for boards to properly address the cyber risk in the UK. Its provisions are not specific to the UK and other non-UK organisations may find them helpful.

Steps for you to take

(Taken from the UK Government's draft Cyber Governance Code of Practice, 23 January 2024)

A: RISK MANAGEMENT

- Identify critical digital processes and services.
- Ensure that risk assessments are conducted regularly.
- Take decisions on the level of cyber risk acceptable to the organisation.
- Ensure cyber is addressed as part of the business's wider enterprise risk management and establish senior ownership of the risk (beyond the CISO).
- Get assurance that supply chain risk is reviewed and assessed.

B: CYBER STRATEGY

- Monitor and review the creation and delivery of the cyber resilience strategy.
- Ensure appropriate resources and investment are allocated to cyber.

C: PEOPLE

- Champion communications on the importance of cyber.
- Ensure there are clear cyber policies aligned to the business cyber strategy.
- Undertake training and improve cyber literacy.
- Ensure appropriate metrics are in place.

D: INCIDENT PLANNING AND RESPONSE

- Ensure the organisation has an incident response plan.
- Ensure there is annual testing of that plan.
- In the event of an incident, support executives in critical decisions.
- Ensure a post-incident response process is in place.

E: ASSURANCE AND OVERSIGHT

- Establish a governance structure with clear responsibilities and ownership at various management levels.
- Establish a regular monitoring process.
- Establish a regular two-way dialogue with senior executives, including but not limited to the CISO.
- Establish formal reporting on a quarterly basis.
- Determine how internal assurance can be achieved.

FURTHER READING

> Linklaters: The Cyber Security Handbook
> UK Government: Cyber Governance Code of Practice: call for views
> NCSC: Cyber Security Toolkit for Boards

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4 M&A: Making sure you cross the finish line

Following an unusual year in 2023, where total public M&A deal value remained low, we look ahead to what M&A transactions will encounter in the coming months.

As we noted in our article "What's in Store for 2024", a variety of factors slowed down the market for higher end-value deals last year. One of these was an increasingly unpredictable regulatory environment. M&A timetables remained long (due to the range of merger control, foreign investment and other approvals needed). It also became more challenging to predict which transactions would be called in for a more in-depth review.

As financial sponsors come under increasing pressure to pursue strategic transactions, we set out some of the key antitrust and regulatory risks to such transactions – and how this may affect dealmaking.

Four key regulatory trends to consider during deal deliberations:

1. Scrutiny of private equity and below-threshold deals

Regulatory authorities are intensifying their examination of serial private equity deals and smaller acquisitions that may collectively impact competition (even if unproblematic individually).

In particular, merger enforcers have been clamping down on the use of PE strategies such as roll-ups, bolt-ons and carve outs – the US and UK authorities have been particularly vocal.

Acquisitions by large digital market players or platforms (even small deals, without overlaps) will face lengthy reviews and difficulty securing approval. Enforcers will be more aware of such deals, given obligations on large platforms under the Digital Markets Act and the UK's incoming digital rules, to flag planned acquisitions.

2. Watch out for divergent deal outcomes

Merger authorities in different jurisdictions may not always reach the same conclusions on a transaction. This unpredictability, whether in the form of remedies suggested, or indeed whether the deal should be cleared or prohibited (see *Amazon/iRobot* and *Booking/Etravelli* in recent months), may pose a risk for the timetable and viability of global transactions, involving multiple filings.

3. Political and public interest factors in deal planning

Non-traditional factors can (and are) influencing regulatory approvals for M&A transactions. For example, new US merger guidelines prioritise a deal's impact on labour markets. Sustainability matters too; although there are no UK or EU cases on this, the Australian competition authority found that the public benefits of a recent acquisition (by increasing investment in renewable power) outweighed its anti-competitive effects.

Political concerns are of increasing importance - not least in investment screening, where national security fears have propelled the spread of regimes globally. But while established regimes are showing some signs of pragmatism, attention in the US, EU and UK is also shifting to plans for outbound investment screening, aimed at stemming investment into critical technologies abroad.

4. Engage early on the FSR

The EU's Foreign Subsidies Regulation – aimed at tackling unfair advantages from non-EU subsidies – continues to require detailed notifications of certain M&A (and public procurement) transactions. Companies may need to disclose a broad range of (potentially untracked) "financial contributions" received from non-EU governments. Notifications trigger a standstill obligation for transactions, until clearance is obtained. Early preparation and dialogue with the regulator are proving key – particularly for unproblematic contributions – to avoid delays. And horizon scanning is crucial – the regulator recently carried out its first surprise raid of a company under the FSR, based on information it had received.

WHAT DOES THIS MEAN FOR YOU?

- Deals will see increased complexity and increased regulatory considerations.
- When undertaking M&A activity, fleshing out merger control, investment screening and FSR risk early in a transaction and factoring their potential impact into the deal timetable and conditions will help avoid unexpected hiccups later down the line.
- Potential bidders must factor in regulatory risks when considering how to make their offer more attractive to a target board.

FURTHER READING

- What's in Store for 2024
- FTC Rolls Up on Private Equity Serial Acquisitions
- Explore our Competition regulation in digital markets: 5 Themes in 5 Minutes (4th Edition)
- Platypus/Rhino – the break-up album
- Antitrust & Foreign Investment Legal Outlook 2024
- Foreign Subsidies Regulation
- Private Equity and Financial Sponsors: Navigating the Regulatory Minefield in 2024

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5 DEI: How to lead without going offside

Diversity, equity, and inclusion (DEI) are boardroom agenda items. Whilst much of the focus has been on achieving greater board diversity, the spotlight is increasingly moving towards the senior leaders' responsibility for the organisation's overall D&I strategy.

In a challenging landscape, with a variety of attitudes towards DEI being expressed by stakeholders, and legal limitations on what actions can lawfully be taken to improve DEI, how do decision makers safely drive change from the top? To what extent should you intervene or let change happen organically?

> "Applying a DEI lens to all decision-making may be the only authentic way for boards to achieve meaningful and sustainable change in DEI, whilst mitigating the potential challenge of positive discrimination and avoiding the meritocracy trap."

The challenging landscape

The current landscape for prioritising action to improve corporate DEI is more fragmented than ever before. To make sound, well-informed decisions in this area, sponsors and portfolio companies must be alert to the battle of forces at play.

- At a societal level, organisations and their business leaders are expected to prioritise DEI but are also facing conflicting views characterising DEI as 'wokeness' or raising concerns over misplaced priorities on DEI at the expense of profit and stakeholder interest.
- At a legal level, employers are permitted to take positive action to achieve progress on DEI but must do so in an environment of increased scrutiny and heightened legal risk of claims of unlawful positive discrimination.
- At a regulatory level, DEI is increasingly becoming part of the supervisory and enforcement framework. In the UK, for example, the financial services regulators have recently published proposals making clear that boards should be responsible for oversight of a firm's DEI strategy.
- At a political level, DEI is a common policy issue and used to differentiate ideologies of politicians across the political spectrum, with new proposals either to accelerate or reverse DEI strategies and protections for disadvantaged groups being championed, any of which will have long-term impacts for businesses.

In such challenging times, what can sponsors and portfolio companies do?

Targets: Though an effective tool to drive forward short-term progress on DEI, targets can also carry greater legal risk. Many organisations set voluntary targets or commit to diversity benchmarks to improve short-term DEI. While the setting of targets themselves is not unlawful, the measures firms take to achieve them can be if targets are in fact treated as quotas rather than aspirational goals.

Incentives: Many organisations already use non-financial metrics linked to DEI in their performance and remuneration assessments. Whilst doing so can demonstrate business leaders are taking DEI seriously, it is difficult to translate DEI metrics into short- and medium-term remuneration targets, and setting remuneration policies which link directly to the achievement of DEI targets may also have the effect of incentivising behaviours which could be seen as positive discrimination. The challenge of setting stretching, but not too stretching, targets has also led many business leaders to consider long-term shareholding as a better alternative to achieve sustainable progress on DEI.

The gift of time: Over the next generation, a broader cohort of diverse candidates should, in theory, be climbing the corporate ladder and entering the talent pool at firms which foster healthy cultures of inclusivity and equality. The focus by boards should not, therefore, just be on short-term diversity progress, but long-term initiatives necessary to nurture the next generation of talent coming through the ranks. Boards are instrumental in developing the right environment and culture for this.

The DEI lens: Ultimately, there are tools which sponsors and senior leaders in portfolio companies can use to intervene and drive short-term results in DEI. But efforts may be futile unless the decision-makers' mindset on DEI is applied holistically and embedded within an organisation's governance framework. From acquisition to risk management, to policy, finance and succession planning, to managing strategy and performance: applying a DEI lens to all decision-making may be the only authentic way for boards to achieve meaningful and sustainable change in DEI, whilst mitigating the potential challenge of positive discrimination and avoiding the meritocracy trap.

FIVE FOCUS AREAS FOR YOU TO CONSIDER

1. **Social mobility:** Organisations are increasingly recognising the need for workplace diversity initiatives to cover socio-economic backgrounds. Expect greater focus on socio-economic diversity of boards in the coming years.
2. **Diversity shortlists:** Be watchful of relying on candidate shortlists based on diversity strands. Such measures have become common practice but carry great legal risk and may be unlawful.
3. **The regulatory spotlight:** DEI is increasingly becoming a regulatory concern, as regulators recognise that good diversity and inclusion practices promote healthy cultures, sound risk management, reduce groupthink and facilitate better decision-making. Whilst changes to legal frameworks can take time to come into force, regulatory change can happen quickly. Fund investors are also increasingly demanding good quality reporting and progress updates on DEI from sponsors.
4. **Positive action vs positive discrimination:** The assumption that well-intentioned measures designed to correct historic unfairness will be lawful has never been a safe assumption, and as challenges of positive discrimination become better known and more prevalent, understanding this often blurred line has become ever more important.
5. **The political agenda:** DEI is increasingly becoming politicised and used to frame party manifestos. In the UK, for example, Labour, the current opposition party, has already committed to mandate ethnicity pay reporting if it makes it into government, alongside a new Race Equality Act, enabling minority ethnic and disabled workers to bring equal pay claims.

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6 Navigating the shift towards a low carbon economy: How to stay the course

> It's not a question of 'if', it's just a matter of 'how soon'"[4]

Despite growing anti-ESG and anti-net zero sentiment in some quarters, the broader economic landscape is unmistakably moving towards a lower carbon economy. Governments and companies see tangible benefits to be won from the drive to get to net zero, not least energy security, economic growth, job creation and a safer climate. Even as some governments dial down their green rhetoric in public, behind the scenes legislation continues to proliferate.

For businesses, staying ahead means integrating the management of climate and other ESG risks with the pursuit of new opportunities presented by this transformation.

To assist you with cutting through the 'noise', we have identified five critical areas for consideration and action in the coming year.

1. Ensure that transition plans are translated from ambition into action

The global stock take at the end of the UN's COP28 climate conference did not make for happy reading: much more will be needed from businesses for a successful transition to a lower carbon economy.

Pressure will therefore increase on companies – whether or not operating in an emissions-heavy environment – to engage fully with drawing up and/or fleshing out robust and transparent climate transition plans.

That pressure will come from both fund investors, who are increasingly focussed on this area, and policymakers, including in the UK and the EU, who are considering making the disclosure of transition plans mandatory.

It will be important to ensure the robustness and scope of your transition strategies, understanding the concrete actions necessary for goal achievement, and establishing how progress towards these goals will be tracked and reported.

The UK Transition Plan Taskforce's framework and guidance serves as an excellent benchmark for evaluating the strength of these plans and are anticipated to shape future compulsory reporting standards. Interest in the TPT's recommendations has reached far beyond UK borders, and it's expected that international regulatory bodies will integrate aspects of these guidelines into their own regulations.

2. Get to grips with climate and sustainability disclosure regimes

The two ISSB global sustainability disclosure standards published last year did a brave job of trying to reflect and encapsulate in one place the many standards and guidance for climate and sustainability disclosure. As a number of countries, including the UK, deliberate on how to incorporate these ISSB standards into their own laws, it's clear that the EU's Corporate Sustainability Reporting Directive – with its comprehensive European Sustainability Reporting Standards – is setting a more demanding bar. The EU's CSRD uniquely requires companies to report not just on how environmental issues affect them, but also on their impact on the environment – known as the "double materiality" requirement.

4 *International Energy Agency Executive Director Fatih Birol*

The EU approach, as well as emerging disclosure developments in the US, will significantly shape multinational companies' sustainability reporting.

Beyond the specifics handled by reporting and legal departments, the audit committee will need to review revised disclosure strategies to integrate information from across the corporate group into a cohesive, transparent narrative that meets diverse jurisdictional demands. The investment of time, money, and effort to comply with these diverse and stringent climate and sustainability disclosure regimes should be carefully planned for.

Businesses should also watch for developments surrounding the Taskforce on Nature-related Financial Disclosures. The TNFD aims to do for nature what the TCFD did for climate. Much will hinge on how widely the new framework is taken up in 2024 by the private sector and national regulators.

3. Remain alert to the risk of greenwashing (and its opposite, greenhushing)

In 2023, greenwashing – the practice of overstating a company's environmental efforts – emerged as a critical issue, and it's expected to remain in the spotlight throughout 2024. Regulators in advertising, consumer protection, and finance have been clear: providing a substantiated and balanced view in marketing and disclosures is crucial and "greenhushing" (not saying anything, or saying less, about your green credentials) is not the answer. The threat of legal action for misrepresenting green or net zero practices is a real and present danger.

While it's widely understood that environmental claims must be transparent, honest, and non-deceptive, the scrutiny is intensifying, extending to subtle implications in imagery, implied associations, and carbon offsetting assertions.

Sponsors and their portfolio companies should seek to assess their internal governance processes relating to communications, including public statements, website content, and advertisements and product and corporate advertising. They should aim to ensure that they adhere not just to the letter but also to the spirit of regulations. Having a strong, risk-based governance and control framework that critically assesses ESG and greenwashing risk and how to manage this is key.

4. Get ready for stricter rules on human rights and environmental due diligence

The European Union is setting the stage for stringent measures to ensure companies are responsible for their impact on human rights and the environment. The upcoming Corporate Sustainability Due Diligence Directive, (colloquially known as CSDDD or CS3D), will make it mandatory for companies to examine and address how their operations – and those of their entire supply chain – could harm human rights and the environment.

While these measures build on established voluntary principles around which there has been longstanding business convergence, they will significantly step up the level of accountability for businesses within the EU, as well as their global partners. Sponsors will want to understand how senior management teams (including across portfolio companies) are preparing for the new rules and any risks or business implications.

Additionally, businesses must navigate other emerging due diligence regulations, such as the EU's rules against deforestation and forced labour, and the UK's impending deforestation policies, not to mention existing supply chain laws in nations like Germany, France, and the US. It's a complex landscape, but having the proper governance mechanisms in place should enable businesses to manage the risks.

5. Use your directors duties as a roadmap to manage ESG in a more polarised world

As the discourse on ESG becomes increasingly charged, the landscape is marked by political instability and diverging stakeholder views. This creates complex scenarios for boards who must navigate the varying demands and perspectives of different stakeholder factions.

For boards, these multifaceted decisions require a delicate balance of diverse, and at times contradictory, considerations. The fundamental legal duties of directors can be an indispensable guide: considering all relevant factors, acting in good faith and using reasonable care when deciding what is most likely to promote the success of the company will be crucial for withstanding external scrutiny from both media and legal viewpoints.

Moreover, boards can draw reassurance from the judiciary's long held stance on respecting business judgement. Recent rulings by UK courts, for example, have given short shrift to claims by climate activists that the board has somehow failed in its duties because of their handling of climate risks. Those decisions were not a surprise and reinforce the principle that it is the prerogative of the directors to determine the most fitting course to the company's success and how to resolve strategy-related disagreements.

FIVE ISSUES FOR YOU TO CONSIDER

1. **Actionable transition plans:** Review your climate ambitions and translate them into measurable actions and milestones. Consider using frameworks like the UK's Transition Plan Taskforce for guidance.
2. **Implications of disclosure and reporting:** Understand from senior management and the audit committee how they are ensuring transparency and consistency across different divisions and jurisdictions.
3. **Anti-greenwash vigilance:** Understand the internal governance mechanisms in place to ensure green claims, in whatever form, are substantiated, balanced, consistent and comply with regulatory standards.
4. **Growing due diligence requirements:** Consider the impact of forthcoming human rights and environmental due diligence obligations on operations and any risks.
5. **Directors' duties focus:** Use directors' duties as a compass for ESG decision-making, balancing stakeholder interests amidst a potentially increasingly polarised landscape.

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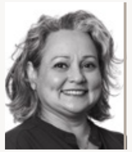

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