Baker McKenzie.

Funds and Investment Management Risk Radar

Financial Institutions | September 2025

Funds and investment management risk radar

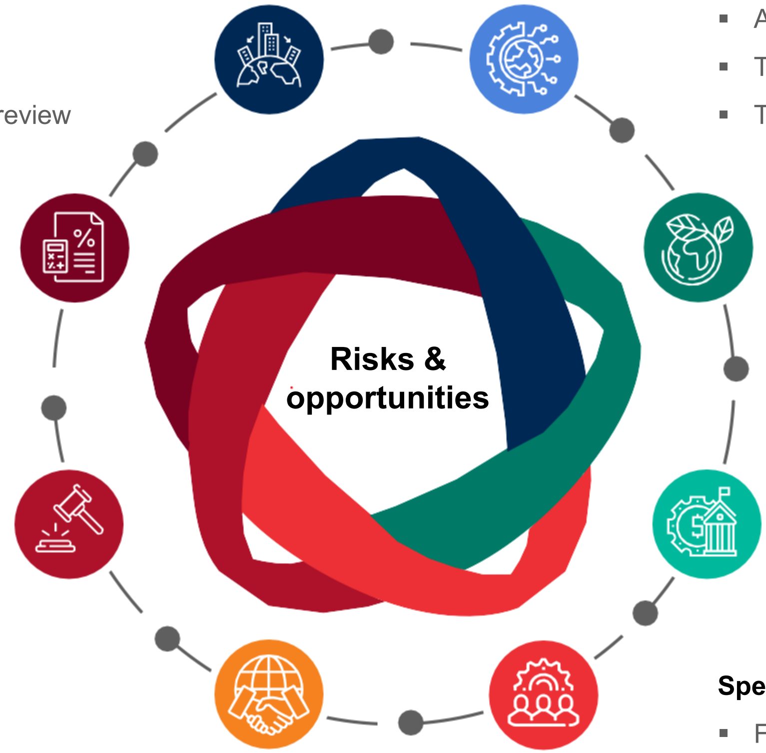
Overview of trends and recent developments

- Private capital continues to expand even in a time of economic uncertainty, with approximately USD 12 trillion in assets now under management (McKinsey). The private credit segment is estimated at USD 2.5 trillion and increasing (BIS). Investors are adjusting to reducing interest rates and slower growth by focusing on long-term strategies. Private equity firms are becoming more selective, looking for businesses they can help grow steadily. Private credit is stepping in where banks are pulling back or partnering with them, offering flexible loans to companies that need funding but may not fit traditional lending models. In Asia Pacific, private capital is gaining ground, especially in markets like India and Southeast Asia, where demand for growth capital and infrastructure investment is strong.
- Although the size of the asset management market globally (i.e., alternatives, pension funds and retail and institutional funds) is significant, approximately USD 145 trillion and growing (PwC), asset managers are rethinking their strategies to stay competitive. Many are merging with or acquiring other firms to build scale and offer broader services. This wave of consolidation is reshaping the industry, with larger players gaining ground. At the same time, managers are expanding into private markets and offering more tailored investment options. New products are making it easier for individual investors to access alternative investments, which were once limited to institutions. Technology is playing a key role in this shift, helping firms improve performance, reduce costs and better understand investor needs.
- Digital tools are changing how investment firms operate. Artificial intelligence (AI), blockchain and data analytics are helping firms make faster decisions, manage risks more effectively and improve client service. In private markets, technology is speeding up deal-making and helping firms monitor their investments more closely. Asset managers are using data to spot trends and respond more quickly to market changes. One emerging trend is the tokenization of funds, where investments are represented digitally on blockchain platforms — potentially improving access, transparency and efficiency across the industry. This digital transformation is becoming essential for managers that want to stay ahead.
- Environmental, social and governance (ESG) issues are now central to investment decisions, but the approach varies by region. In Europe and the UK, regulations are pushing firms to be more transparent and accountable. Climate-focused funds and investments that support the transition to a greener economy are gaining traction. However, in the US, there has been a growing pushback against ESG investing, with some states and political groups questioning its role in financial decision-making. This divide is creating challenges for global firms trying to maintain consistent policies across markets. Despite this, investor demand for sustainable finance remains strong, and firms are working to improve how they measure and report impact.
- Regulators are increasing their focus on how investment firms manage risk and protect investors. In the UK and EU, there's growing attention on how funds handle liquidity and value their assets. Firms must also manage broader risks, including cybersecurity threats and political instability. Strong governance and clear communication with investors are more important than ever. In Asia Pacific, regulatory frameworks are evolving quickly, with some markets introducing new rules to attract foreign investment while ensuring stability.
- This "risk radar" looks at some of the trends and risks faced by the sector. We look forward to engaging with you on these topics.

Against a backdrop of market uncertainty, challenges such as digitalization, growing regulatory scrutiny and sustainability, must be navigated and the opportunities seized by the sector.

Funds and investment management

Summary of risks index



Geopolitical (4)
- Global instability
- Sanctions
- Foreign investment review

Technology (5)
- AI and ML
- Tokenization
- Technology and talent management

Resilience (6)
- Operational risk
- Cyber risk
- Compliance uncertainty

Sustainability (7)
- Greenwashing
- Disclosures and regulation
- Due diligence

Specialized finance (8)
- Funds finance
- Adaptation finance
- Private credit

Workforce redesign (9)
- Inclusive workplace
- Noncompetes and protection of confidential information
- Executive exits

Private equity M&A (10)
- Regulatory hurdles
- Due diligence
- Post-acquisition integration

Litigation and enforcement (11)
- Climate-related
- Transactional disputes
- Antitrust

Taxation (12)
- International tax and transfer pricing
- Sustainability and transparency
- Carried interest

Geopolitical

Risk profile

Recent trends and developments

- Geopolitical risk impacts funds and private equity by increasing market volatility and uncertainty. It can lead to lower investment, higher costs and disruption to transactions. While it's possible to overstate the market impact on equities, the fallout on local markets (e.g., specific assets) can be significant.
- Investors must navigate these risks carefully, considering factors like regional instability, regulatory changes, human rights considerations and economic sanctions. Having the right tools in place to identify and effectively manage risk is essential. While geopolitical risk can negatively impact investments, returns may be boosted from assets in other perceived safe havens. Therefore, geopolitical risk is an increasingly important factor to consider when constructing investment portfolios.

Risk Rating: **Moderate**

Associated risks

Global instability

Since the end of the "US-led" world order, the last 20 years have seen increasing global instability characterized by high-risk geopolitical events. This is having far-reaching and long-lasting effects on the investment climate and risk exposures. Investors also face reputational risks for being on the "wrong" side of a conflict. Given changing threat profiles, managers must identify vulnerabilities and assess the likely effects on investment values and their liquidity, developing contingency plans in response. The imposition and subsequent escalation of tariffs by the US administration risks disrupting established trade flows. These measures introduce further volatility and inefficiencies into global supply chains and heighten uncertainty in cross-border commerce, with knock-on effects on financing structures and investment planning.

Sanctions

Recent financial and trade sanctions pose complex challenges for financial sponsors. The rapidly changing sanctions landscape, especially in the wake of geopolitical events such as the war in Ukraine, means that general partners and investment managers must be vigilant about their investors and investments. Sanctioned assets may become illiquid or quickly lose value, impacting fund performance and investor returns. It is important to take steps to check that neither investors nor investments are subject to sanctions. This requires thorough due diligence and the implementation of sanction-specific risk-mitigation strategies. It is important to have appropriate systems and controls, and contractual provisions allowing proactive steps where investments may contravene sanctions law. This of course increases operational complexity and costs.

Foreign investment review (FIR)

Over the last decade, increasing numbers of jurisdictions have adopted FIR-type legislation, such as the EU, UK, Japan and the US, significantly impacting funds and private equity transactions. In the US, the Foreign Investment Risk Review Modernization Act, implemented by the Committee on Foreign Investment, expands the review of foreign direct investment transactions. It especially affects noncontrolling investments in US businesses involved in critical technologies. While a February 2025 "Foreign Investment Memo" eases some regulatory burdens for US allies, investors from China and other "adverse" countries will see significantly expanded restrictions. Consequently, there may be increased delays and uncertainty over transactions involving non-US investors that might raise US national security issues.

Baker McKenzie solutions — key issues we advise on

- Regulatory compliance and risk management: anti-bribery, corruption, sanctions and AML
- Customer and institutional relationship due diligence
- Disclosures, filing and reporting requirements; regulator questions, audits and investigations
- Cross-border commercial arrangements and agreements
- Sanctions and export controls, and foreign investment reviews
- Product offerings and new market due diligence
- Management of commercial contract sanction-related issues
- Third-party supplier compliance

Technology

Risk profile

Recent trends and developments

- The asset management sector is under pressure to cut costs, scale up and provide greater value, which is exemplified by the trend toward low-cost, passive funds. Moreover, generally, for financial sponsors to pursue sustainable-friendly investments, large amounts of unstructured and incompatible data must be analyzed.
- Technology can help. AI can efficiently and quickly process huge amounts of data to apply to sustainable investing. It also has the potential to be used for client outreach and to make front and back offices more efficient, as well as identifying investment opportunities, reporting to clients and responding to the regulatory imperative of better monitoring employee conduct risks.
- Despite the considerable sums that have been invested in technology such as AI, this is yet to translate into higher levels of productivity.

Risk Rating: **High**

Associated risks

Artificial intelligence

Both AI and machine learning are potentially transformative for the sector. The advent of generative AI has raised the technology's profile even further. It is increasingly in use across a range of applications, e.g., portfolio optimization and to automate client interactions — most commonly with chatbots. It is proving capable of summarizing research and due diligence, as well as writing technical documents such as financial analysis, and ESG reports. Agentic AI systems designed to "think and do" like human agents are of growing interest. AI requires proper management and governance of its inherent risks. Transparency and explainability remain major legal risks exacerbated by weak AI governance. Regulation is increasing; jurisdictions are adopting different approaches from risk- and principle-based, to decentralized and state-driven.

Tokenization

Tokenization of assets brings benefits — reduced cost and increased efficiency. A "unified ledger" is created that brings all elements together on one platform, facilitating speed of settlement and fractional ownership that "democratizes access" — an innovative approach to the ownership or funding of relatively illiquid assets, such as real estate. In the last few years, we have seen a "tokenisation wave," initially focused on digital bonds, but, more recently, it has also covered other real-world assets, such as investment funds and equities. There are notable risks. Despite regulatory developments, legal analysis of the nature of tokens is still in its initial stages; moreover, there is little international consensus and coordination between lawmakers and regulatory authorities. There is at present a lack of interoperability between tokenized assets and platforms together with questions over scalability. Cost is a further challenge because the investment costs of a first mover are typically high.

Technology and talent management

The impact of digital transformation means that businesses in the sector must ensure that their workforce adapts to the new market environment by reskilling existing employees and recruiting new talent. The sector needs to recruit more digitally and IT-trained staff (e.g., in AI and cyber), and, in doing so, it must compete against a range of businesses including technology companies and fintechs to secure and keep the best talent. Additionally, existing staff must adapt and upskill to work with new technologies or see themselves become redundant. A failure to do so puts businesses, potentially, at a competitive disadvantage and leaves them reliant on the use of outdated systems, subject to slower decision-making and poorer data quality, thereby responding more slowly to changing markets.

Baker McKenzie solutions — key issues we advise on

- Integrated global cyber and data security response
- Cloud computing
- 5G
- AI and ML
- Evolving/increasing regulation of smart tech
- Contracting for new and improving tech
- IP protection for smart tech
- Tech trade wars
- External tech investments/financing
- Blockchain and tokenization
- Issue of digital bonds on a public blockchain
- Smart contracting
- ESG data
- Robotics

Resilience

Risk profile

Recent trends and developments

- Maintaining operational resilience can be complex, especially for organizations that span multiple regions and regulatory frameworks, each with distinct supervisory obligations. However, there are common principles and proven strategies that can support both regulated and nonregulated entities in strengthening their resilience and enhancing business continuity initiatives.
- Regulatory pressure to act has intensified globally in 2025, particularly around cyber risk and third-party risk management. In Europe, the EU's Digital Operational Resilience Act mandates stringent security and continuity requirements for financial entities. Regulators are converging on resilience standards, with jurisdictions like the UK, Singapore and Australia embedding third-party risk into operational resilience frameworks.

Risk Rating: **High**

Associated risks

Operational risk

Investment and fund managers should prioritize an understanding of the systems and processes that support key services to customers, including those outsourced to third parties, especially financial market infrastructure and data vendors. They remain responsible to regulators notwithstanding any contractual provisions. Globally, regulators now expect firms to embed resilience into governance, risk management and outsourcing arrangements — ensuring continuity of service to clients and markets even in the face of severe but plausible shocks. This includes risks from cyberattacks, technology failures, third-party service disruptions and regulatory breaches. This is now a strategic imperative, not just a compliance issue. Changes in regulation, technology and to the business environment may require adjustments to strategy around operational resilience.

Cyber risk

The financial sector has been the target of one in four such attacks in recent years. The average cost of a data breach in the financial industry is close to USD 6 million (Statista). Digitization provides a fertile environment for cyberattacks, a risk ranked by many financial institutions and regulators as preeminent. There is growing complexity in legislation and regulation worldwide that is more challenging to manage. Reporting obligations are getting stricter. Again, there are recent and numerous examples of cyber incidents on market participants that are not themselves large, but which have a large-scale ripple effect. Many breaches would have been prevented but for better cyber hygiene, for example, failing to properly carry out risk assessments or deploy patches in a timely manner. The potential misuse of AI to launch cyberattacks has only further heightened concerns.

Regulatory and compliance uncertainty

Regulatory and compliance risk is a critical strategic concern. Cross-border operations further complicate compliance, as firms must navigate divergent national regimes, each with their own reporting standards, licensing requirements and enforcement priorities. The lack of harmonization increases the risk of inadvertent breaches and inappropriate regulatory arbitrage. Firms must look to put in place robust operational resilience frameworks to manage disruptions when inevitably they occur, particularly in view of growing cyber threats. As regulators globally sharpen their focus on resilience and digital risk, private capital and, especially, investment and asset managers operating in this space must proactively enhance controls to mitigate exposure and maintain investor confidence. It's important that the second and third line of defense are adequately resourced and that where failings are identified they are documented and remedied promptly.

Baker McKenzie solutions — key issues we advise on

- Cyber incident risk mitigation and response
- Investigations into IT outages
- Advisory on policies, cybersecurity, e-business models and processes
- Operational risk and resilience
- Outsourcing, risk management, disclosures, filing and reporting requirements
- Managing business change and disruption
- Understanding senior manager responsibilities and liabilities
- Advice on product offering, cross-border activities and market conduct offenses
- Forming and maintaining strong regulator relationships

Sustainability

Risk profile

Recent trends and developments

- Financial institutions are critical players in the transition to a carbon-neutral economy because of their role in allocating capital. In recent years, the incoming tide of sustainable finance has seemed inexorable. Change is afoot, however. A new European Commission is pursuing a simplification package for regulation, the US federal administration has rolled back ESG measures, with other countries also prioritizing growth agendas over net-zero targets. Nonetheless, sustainability whether, for example, through transition plans or adaptation finance looks here to stay.
- Jurisdictions have different approaches to regulation and reporting that may not always be compatible, complicating cross-border financial services, for example, the marketing of funds. However, the growing adoption of global minimum standards from the ISSB should bring greater interoperability.

Risk Rating: **High**

Associated risks

Disclosure and regulation

Sustainability-related disclosures to investors, whether mandatory under the EU's Sustainable Finance Disclosure Regulation (SFDR), or under voluntary standards, are quickly becoming the norm in many jurisdictions. These requirements apply at entity and product level and distinguish between all financial products and those targeting or promoting environmental or social objectives. The challenges in implementation range from the availability of the underlying data to uncertainty over the interpretation of regulations. While the SFDR was originally meant to be a disclosure regime, it has for practical purposes been treated as a sustainability labeling regime, and where uncertainty over interpretation has led to confusion over the degree of sustainability of many funds marketed to investors. Consequently, it is expected to move closer to a labeling regime.

Due diligence

Performing quality due diligence is always important. For sustainability-driven investments, the stakes are particularly high. ESG rating products can spot risks not identified with conventional financial analysis that nonetheless could affect financial performance because of additional operational costs or litigation liabilities. The dilemma is that ESG ratings are still open to interpretation, being only as good as the methodology and the data employed, potentially lacking independent verification. Ratings also rely on public information, so their outputs will necessarily be subject to data gaps. Some jurisdictions have now introduced regulations on ESG rating agencies to safeguard standards, while others are actively contemplating this step.

Greenwashing

There is no general authoritative definition of greenwashing, but in the EU, the European Supervisory Authorities refer to it as "a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial service." Consequently, consumers, investors and other market participants may be misled. Examples include cherry-picking, omission, ambiguity, exaggeration and misleading terms. Financial sponsors could be at risk of regulatory action and potential litigation where greenwashing is alleged. While to date few cases have been brought, the topic is high up in supervisors' priorities, for example, in the US and Australia.

Baker McKenzie solutions — key issues we advise on

- Compliance with sustainable finance regulatory reforms, including pre-contract and public disclosures and reporting
- Cross-border marketing of funds requirements and compatibility of ESG standards
- ESG regulatory considerations for transactional product offerings (e.g., green bonds, sustainable financings, etc.)
- Due diligence (DD) requirements including the EU corporate DD legislation, internal governance, taxonomy compliance and definitional issues
- Mitigating the risk of exposure to greenwashing allegations
- Disclosure, reporting and due diligence obligations of PE portfolio companies

Specialized finance

Risk profile

Recent trends and developments

- Demand for private credit has risen significantly, filling a gap left by traditional bank lending after the 2008 financial crisis. Private credit funds under management total approximately USD 2.5 trillion (BIS) and expected to continue growing. Direct lending, for instance, has offered higher returns compared to leveraged loans and high-yield bonds. However, in the syndicated loans market, as borrowers refinance, banks are regaining market share — placing direct lenders under pressure to stay competitive.
- Private fund sponsors have had to manage a slowdown in M&A activity due to higher interest rates, making exits from investments more challenging. Private equity firms are sitting on record amounts of unsold assets, making it harder to return cash to investors. GP-led liquidity solutions (e.g., preferred equity) have become increasingly popular, also involving private credit.

Risk Rating: **Moderate to high**

Associated risks

Private credit

Private credit is competing with banks to fund corporate acquisitions. It has grown exponentially, serving smaller and mid-size corporates as an alternative to leveraged finance and public bonds. It is diversifying into a wide range of assets from direct lending to commercial real estate and asset-based financing structures. However, private credit can be more exposed to borrowers than banks, which are constrained in their lending by regulation including capital requirements. Funding and liquidity pressures may also see a reduction in the availability of wholesale financing or a mismatch between asset maturities and liabilities. The International Monetary Fund has warned that corporates borrowing from private credit tend to be smaller and riskier than their public market counterparts. Moreover, the sector has never experienced a severe economic downturn at its current size and scope.

Funds finance

In recent years, the private funds sector has developed various tools and strategies to help sponsors access further capital at the fund level during the life of the fund, when the fund sponsor's capacity to draw capital from its existing investors may be constrained. These are commonly referred to as "GP-led liquidity solutions" or "GP-leds." The challenge for any sponsor is to determine which liquidity solution is most appropriate for the requirements of its funds, portfolio companies and investors. Here, among other matters, it is crucial to manage the conflicts of interest that often arise with GP-leds and to provide sufficient disclosures to limited partners. From the perspective of funds as borrowers of fund finance facilities, their increasing use and complexity is likely to face growing scrutiny from fund investors, particularly for NAV facilities, with some investors raising concerns regarding the extent to which these facilities may be used to fund distributions.

Adaptation finance

There is a very significant financing gap to speed up adaptation to the demands of climate change. The global adaptation finance gap is estimated to be between USD 194 billion and USD 366 billion per year (NAP Global Network), indicating a significant shortfall in funding. The LSE and Grantham Institute explain that there is an opportunity for an exponential increase in private finance that will require ongoing collaboration between public and private actors. However, adaptation investments are often considered high risk due to their perceived and, at times, actual low returns, as well as the challenges associated with monetizing their benefits. A lack of information regarding climate risks makes it challenging to price risks accurately. There is also a lack of common market language, standard definitions and classification framework.

Baker McKenzie solutions — key issues we advise on

- Blended, impact, adaptation and transition finance, etc.
- Structuring and issuing ESG-related offerings and instruments
- Performing due diligence on issues, accounts and auditors, including the sustainability attributes of contemplated transactions
- Liaising with third-party ESG reviews
- Preparing and managing transactional and regulatory documentation and notifications, such as the prospectus and content of specific ESG reports and annual filings
- Advice on lending including GP-leds and direct lending
- Reviewing conditions precedent (e.g., legal opinions and auditor comfort letters) and drafting own opinions
- All taxation aspects of transactions

Workforce redesign

Risk profile

Recent trends and developments

- Inclusion, diversity and equity (ID&E or DEI in the US) are key social factors within ESG concerns that require careful navigation by firms. Research suggests that misconduct is often linked to governance failures. Greater diversity and a "speak up" environment improve the risk management culture, and studies show a decrease in the frequency of fines for misconduct.
- In the US, executive orders are targeting what are described as illegal DEI: ending DEI efforts in the federal government, including diversity programs and eliminating all related offices and positions; a new policy that the US will recognize only two sexes, male and female — signaling a rollback of transgender protections — and directing federal agencies to clamp down on so-called illegal discrimination from federal contractors and publicly traded corporations.

Risk Rating: **Moderate**

Associated risks

Inclusive workplaces

Businesses of all types should ensure that all staff are treated equally and protected from bullying, harassment and discrimination. Whistleblowing processes should be effective, and employers have duties to address the well-being and health and safety of their employees — mental health in particular was brought to the fore during the pandemic, as individuals worked from home and there was less of a distinction between office work and home life. The focus on ID&E is also relevant for nonfinancial misconduct in the regulatory sector. Financial institutions and their senior managers may be held responsible for cultures that tolerate serious personal misconduct, bullying, racism, discrimination. With Gen Z entering the workforce, businesses that embrace responsible business practices and ID&E may gain a competitive advantage.

Noncompetes and protection of confidential information

Post-termination restrictions and protections around business confidential information continue to face legal scrutiny worldwide but especially in the US. As a result, many employers now seek trade secret protection and, where legally appropriate, other forms of restriction as a more sustainable strategy. Added to this, there is recognition of the benefits and challenges around AI adoption in assessing risk. This trend reflects a broader policy shift aimed at balancing business protection with employee mobility and innovation. Employers are increasingly turning to tailored confidentiality agreements and robust internal data governance frameworks to mitigate risk, especially as remote work and digital collaboration tools expand the potential for inadvertent data leakage.

Executive exits

Senior staff often possess extensive knowledge and experience, including on investment strategy. Their departure can lead to a significant loss of expertise and potentially affect a fund's performance, as well as attracting regulatory scrutiny. It's important to protect confidential information, negotiate enforceable noncompete clauses and have a robust succession plan in place. A well drafted employment contract and, when necessary, a suitably negotiated settlement agreement can help reduce the risks.

Baker McKenzie solutions — key issues we advise on

- Transforming the traditional employment model (e.g., new staffing models)
- Remote working (e.g., legal and regulatory issues, data privacy, trade secrets, tax, real estate)
- Digital progress and its Impact on the workforce (e.g., rise of automation, use of AI, employee surveillance)
- Managing business change and disruption, e.g., carve-outs, post-transaction integration and outsourcing
- Providing the policies and best practices necessary to achieve effective whistleblowing, inclusion and diversity program objectives
- Strategic senior executive recruitment, termination and remuneration
- Advising on the introduction and use of AI technologies in the workplace to ensure innovative yet safe and legally compliant change

Private equity M&A

Risk profile

Recent trends and developments

- Private equity activity has slowed on both entry and exit fronts, with IPOs notably impacted. Limited partners are increasingly relying on the secondaries market to unlock capital. Deal timelines are stretching as funds take a more measured approach to portfolio reviews and strategic decisions. Weak public market valuations may drive more take-private deals. Meanwhile, PE operators are prioritizing bolt-on acquisitions and seeking assets with stronger fundamentals and longer-term value.
- Carve-out transactions are increasingly popular as corporates strategically review noncore assets, providing opportunities for financial buyers to acquire "hidden" (or "trapped") value. This trend sees businesses review noncore assets to streamline their operations in the light of acquisitive interest from financial buyers. It is vital to navigate the "carve-out trilemma": the tension between deal certainty, timing and cost.

Risk Rating: **Moderate**

Associated risks

Regulatory hurdles

In recent years, M&A transactions have faced heightened regulatory scrutiny. Antitrust authorities have tightened the grip of merger control, foreign investment control has been expanded and, in the EU, a new regulatory regime on foreign subsidies is now in force. Therefore, having a well thought-through and detailed "road map" for navigating the regulatory challenges, and enhanced document management practice, is becoming essential for M&A success. Taking merger control, as an example, its focus has broadened from traditional horizontal market-share analysis to new perceived threats for competition in different forms. PE buyers tend not to raise insurmountable competition concerns, and the current US administration has expressed support for M&A in general. The sector's growing importance cannot though be ignored, for example, over serial acquisitions and platform strategies. Antitrust-triggered divestment by corporates generally remains an opportunity for PE, considering the current Department of Justice and Federal Trade Commission leadership have expressed support for merger remedies, specifically indicating a preference for structural divestiture of standalone businesses.

Due diligence

In private equity M&A, due diligence tends to be focused on thoroughly investigating investment potential and risk. This necessitates thorough research of the target's financials, business operations, industry sector and legal risks. Particularly in the carve-out and bolt-on context, the acquisition will often envisage potential workforce reductions, noncore asset sales and business reorganizations, requiring deep legal review, for example, of labor law, contractual agreements with vendors and any regulatory obligations. Due diligence is also a way to uncover hidden antitrust liabilities (such as past collusion) and so avoid delays or fines. With rising use of generative AI, buyers are assessing tech capabilities and data governance more closely. Tailored due diligence is especially important in take-privates, carve-outs and add-on acquisitions.

Post-acquisition integration

Any large post-acquisition integration project requires a strong mix of business strategy, process management, technical expertise and ongoing communication. Once a plan is developed, practical issues will be decisive in determining how quickly it can be implemented and how soon the benefits of the integration can be realized. HR considerations, corporate and tax law issues, and regulatory approval and filing requirements should all be factored in, rather than leaving them to the implementation phase. Workforce and cultural integration are increasingly recognized as key to post-deal success, including talent retention and employee engagement with business leadership. It's important for the project team to focus early on navigating roadblocks that might otherwise delay or frustrate the realization of integration goals. Post-acquisition integration must be carefully managed to avoid gun-jumping, or improper information sharing.

Baker McKenzie solutions — key issues we advise on

- Guiding you through the complexities of carve-out transactions to maximise deal value
- Designing the deal structure and project managing the internal and external advisers
- Conducting due diligence including ESG matters
- Regulatory issues such as merger control, foreign investment control and EU foreign subsidies
- Adopting a cost-effective and smooth transaction process, thus managing costs and ensuring advice is delivered in a swift and pragmatic manner
- Sustainability considerations including disclosures and publication filings
- Anticipating issues and proactively offering solutions to present to the steering committee/PMO for the project and the board
- Maintaining momentum throughout the entire duration of the project

Litigation and enforcement

Risk profile

Recent trends and developments

- The incidence of litigation and enforcement is a key risk. Whether disputes are climate-related, transaction-based, antitrust or otherwise, they require time and resources, including senior management involvement, and their outcome is uncertain.
- For climate-related claims, NGOs and claimants take advantage of the resulting publicity to attract regulatory scrutiny and exert reputational pressure on defendants. These tactics can be met with a coordinated and proactive media and regulatory engagement strategy to ensure a consistent response and avoid traps that could prejudice defense strategy.
- Fund managers face growing exposure over greenwashing. This can arise not only when public statements on sustainability are misleading, selective or incomplete, but also when their products and marketing strategies do not align with their public sustainability goals.

Risk Rating: **Moderate to high**

Associated risks

Climate-related

Climate-related claims have emerged as a significant disputes concern for financial sponsors. There is now a plethora of ESG-related legal and regulatory requirements internationally, which many businesses struggle to keep up with. However, regulation is coalescing toward more consistent global obligations, for example, under the ISSB standards. The risk of litigation will continue to arise where public statements can be viewed as misleading or incomplete, or when products and marketing do not meet expectations. Regulators are focusing on this area, especially on greenwashing cases where, as far apart as the US and Australia, they have brought enforcement action. This will also lead to more civil-related claims especially in jurisdictions with active class action regimes. In the US, the sector also needs to be on its guard against claims against ESG investment policies citing, for example, breach of fiduciary duty.

Transactional disputes

The sector faces a variety of litigation risks. Some are inherent in the financing and acquisition of investments, although they can be mitigated through due diligence and contractual protections. The incidence of litigation can grow in situations of increased risk taking, where sponsors act outside of their core markets, often driven by competitive lending. In situations of distress, sponsors and counterparties may more readily find themselves engaging in litigation (e.g., over valuation adjustments, covenant breaches or restructuring terms). Finally, as legal requirements grow (e.g., FIR regimes) and regulatory scrutiny becomes more intensive generally, the potential for disputes is heightened.

Antitrust action

As the footprint of private equity across economies grows, so do concerns over its competitive impact. This includes the potential abuse of dominant position in the market through "roll-up" strategies, where private equity buys up multiple smaller companies in one industry sector, as well as horizontal shareholding (i.e., minority stakes in multiple competing firms within the same industry). The US Federal Trade Commission is looking at how minority shareholdings can be used to control or influence competing businesses, which can be captured under the Clayton Act's "use of stock" provisions, including through roll-up strategies. The Commission is paying close attention on antitrust grounds to such strategies that consolidate previously unconcentrated industry sectors through multiple acquisitions to the detriment of competition. Follow-on class actions are a risk both in the US and in other jurisdictions. Other jurisdictions are likely to follow suite on antitrust.

Baker McKenzie solutions — key issues we advise on

- Developing a strategy to minimize regulatory enforcement and litigation risk
- Disputes arising out of financing and M&A transactions with counterparties
- Engaging with regulators over possible enforcement action to resolve any contraventions, and settling any consequent enforcement action or guiding you through the regulatory processes advocating your case
- Undertaking litigation where necessary, whether defending an individual or class actions
- ESG-related claims arising from investments, including greenwashing, and claims for breach of stewardship and fiduciary standards
- Advising on competition and antitrust concerns including obtaining necessary consents and minimizing the risks

Taxation

Risk profile

Recent trends and developments

- Shifts in the global tax landscape have increased uncertainty and risks associated with contentious tax matters. As tax authorities become more aggressive, proper planning is critical, as is the need to anticipate and defend against audits.
- The OECD's Two-Pillar Solution is intended to address the tax challenges arising from the digitalization of the economy. In particular, the implementation and application of the Pillar Two rules — which are aimed at ensuring large multinational enterprises pay a 15% global minimum Effective Tax Rate (ETR) on the income arising in each of the jurisdictions where they operate — are complex and present challenges but also opportunities to financial sponsors in the efficient management of their tax liabilities.

Risk Rating: **Moderate**

Associated risks

International tax and transfer pricing

Businesses are facing an ever-changing international tax landscape combined with increased audit activity and tax authorities being proactive in challenging international tax and transfer pricing structures, with demands for even more data to substantiate their calculations. While regulated financial institutions are exempt from Pillar One (although not necessarily any portfolio companies), Pillar Two brings unprecedented changes to the international tax system by introducing a 15% global minimum ETR for large multinational enterprises. Uncertainty persists whilst discussions are ongoing at the OECD level, following an agreement by the G7 to exclude US parented groups from certain aspects of the Pillar Two rules and create a side-by-side system with the US minimum tax rules. Further, multinational portfolio companies may need to adapt to the OECD proposals on taxing rights made under Pillar One, which currently remains under negotiation at the OECD level.

Sustainability and transparency

Tax is increasingly becoming a key part of the sustainability agenda. In recent years, the tax transparency landscape has evolved from the adoption of voluntary standards, such as GRI-207, to legislative regimes, notably including the adoption of the EU Directive on public country-by-country reporting. This requires multinational groups to report specified tax information that is then made publicly available. The first reports have started to be released this year, for example in Romania, which implemented the EU directive early. The focus on increased tax transparency puts pressure on the use of tax havens and tax avoidance initiatives, which is an issue not only for financial entities and, where relevant, their portfolio companies, but also for their investors.

Carried interest

Limited partners in private equity funds have, for many years, benefited from an advantageous treatment of "carried interest" where it is taxed not as income, but as capital gain. However, the tax treatment of carried interest is, for example, currently being reformed in the UK, where the government is committed to taxing carried interest as trading profits subject to income tax and Class 4 National Insurance contributions from 6 April 2026. The UK is seeking to protect its position as a "world-leading asset management hub" and has listened to concerns raised by stakeholders during the consultation process, withdrawing proposals to include minimum co-investment and holding period requirements from the draft legislation. With reform to the tax treatment in one major financial center, others may be tempted to follow (indeed, there are already proposals to reform the carried interest tax regime in the US), and this may lead to key individuals seeking to relocate to other more favorable jurisdictions.

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- Managing the transfer pricing implications of a fast-changing global landscape
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