Global mergers and acquisitions' activity in 2021 broke all prior records – with over 63,000 transactions recorded and a global M&A value of more than $5.1 trillion. We expect 2022 to be another very strong year in terms of M&A deal volume. We have outlined five trends we predict to significantly frame M&A activity this year: (i) enhanced deal scrutiny; (ii) ESG's aspects significance; (iii) the continued growth in the use of W&I insurance; (iv) carving-out of assets increasing deal complexity; and (v) the introduction of a potential corporate re-domiciliation regime for the UK.

TREND #2: ESG CONTINUES TO RISE

2021 saw a significant acceleration of the focus on Environmental, Social and Governance (ESG) themes, a trend that is set to continue in 2022, as both buyers and sellers call for even more attention to ESG credentials. The rise in public concern for environmental and social equity and the ever increasing fund flows into ESG funds mean that the M&A industry, and the PE sector in particular, are having to embrace ESG strategies in relation to both due diligence and acquiring ESG-friendly portfolio companies.

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However, the increasingly complex network of soft-law and hard-law reporting requirements poses a major challenge for companies, which have to untangle the proliferation of ESG providers, standards and benchmarks. Indeed, the multiplication of ESG ratings and indices unavoidably leads to conflicting standards, and the need to adopt industry-wide definitions becomes more pressing.

Nonetheless the hope is that in 2022 companies will get more clarity as several jurisdictions implement mandatory ESG reporting frameworks which are currently being drafted, including notably the UK. The International Financial Reporting Standards Foundation initiative in November 2021, to create the International Sustainability Standards Board, appears to have given momentum to the convergence of the currently fragmented ESG reporting landscape. Whilst there is clearly a broad willingness to provide ESG standards, efforts remain somewhat uncoordinated, as shown by the announcement that the European Financial Reporting Advisory Group is also developing its own sustainability standards.

In the UK, a mandatory regime of climate-related financial disclosures for public companies, large private companies and LLPs came into force on 6 April 2022. This requires relevant businesses to report on a wide range of sustainability and climate-related risks and opportunities in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, reporting on governance, strategy, risk management, metrics and targets. According to the government's statement announcing the legislation, this regime is aimed at helping investors and businesses to better apprehend the financial impacts of their exposure to climate change as a way to support the "greening" of the UK economy.

The new regime will support investment decisions by facilitating the disclosure of material climate-related financial information, enabling investors to be better informed on how companies are likely to be impacted by climate change. This development shall decrease the risk of deals collapsing for ESG reasons (as a survey by Datasite reports that 65% of respondents have witnessed ESG risks kill a deal; and 44% expect environmental concerns to constitute the biggest deal breaker in 2022). Investors will be more readily able to compare companies' exposures to climate-related risks and opportunities and will therefore be better equipped to account for them in their investment and business decisions. The exercise of preparing these disclosures may further help businesses determine what is needed to address these impacts, risks and opportunities, so as to reduce the risk of deals failing due to ESG considerations.

This trend appears to be here to stay, notably, as governments committed to accelerate their actions to slow climate change this decade following the COP26 summit in November 2021.

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Energy companies, which are particularly exposed on the ESG front, have already started to adjust their strategy towards renewables with the view of reducing their oil and gas revenue. By way of an example, Total has set the pace in 2021 and acquired a large number of renewables companies and assets to establish itself as a broader energy company, culminating in its rebranding as TotalEnergies.

The shift away from fossil fuels toward renewables is likely to generate a large amount of M&A dealmaking. This will be driven, for example, by the sale of oil and gas assets by companies who are deploying ESG capital or who fall within the scope of ESG requirements and are keen to decrease their exposure. Finding buyers and ways to raise funds for the purchase of these assets will be key, but demand for fossil fuel assets remains, as shown by the $9.5 billion sale by Shell Enterprises LLC of its Permian Basin assets to ConocoPhillips which was completed in December 2021.

Private equity firms have also continued to invest in fossil fuel assets despite investor demand for greater ESG integration. More and more capital will be mobilized for transition towards greener sources of energy and by major oil and gas companies towards investments in renewables and hydrogen, creating further opportunities for M&A. At the same time, institutional investors are increasingly seeking to align their portfolios with the growing focus on ESG performance, leading to large potential for M&A deal making.

Greenwashing (the practice of overstating the environmental benefits of a product, service or idea) is a significant concern for investors and regulators. The Financial Conduct Authority (FCA), by way of a letter to the chairs of authorized fund managers on 19 July 2021, set out specific greenwashing concerns and identified three examples of behavior which could amount to greenwashing:

i. "a proposed passive fund had an ESG-related name" that was misleading "as it was looking to track an index that did not hold itself out to be ESG-focused";

ii. a fund application claimed to have a strategy to invest in companies contributing to "positive environmental impact". The FCA found this misleading, however, since whilst the fund intended to invest predominantly in low carbon emissions reporting companies, the investments would not obviously contribute to the net-zero transition. The FCA had expected to see a "measurable non-financial objective alongside the financial objective or strategy with information on how that impact would be measured and monitored"; and

iii. instances where the FCA recognized as challenging the reconciliation of the fund's proposed holdings with the statements made setting consumer's expectations. A particular example of this is that a sustainable investment fund containing two "high-carbon emissions" energy companies in its top-10 holdings without providing obvious context or rationale for it.

To help the UK Government tackle "greenwashing", the Green Finance Institute has set up in June 2021 the Green Technical Advisory Group (GTAG) to provide independent advice to the Government to implement a UK taxonomy (a common framework setting the bar for investments that can be defined as environmentally sustainable). The UK taxonomy will build upon international taxonomies, and notably the EU taxonomy and will particularly focus on the UK's transition to net-zero. The UK taxonomy is expected to be similar to the EU's regulation on sustainability disclosures in the financial sector, known as SDFR, which came into effect on 10 March 2021, but will allow for some divergence from the EU taxonomy to ensure its suitability for the UK market. However, it is recognized that international alignment is desirable and that any divergence from the EU taxonomy should be carefully considered. As such, SDFR will provide a useful building block that the GTAG will be able to use to develop more swiftly the UK version.

ESG policies will need to be coherent, meaningful and properly implemented to avoid the risk of reputational and business damage. As such, we can expect deals to be motivated by enhancing their ESG credentials, as well as seeking to sell non-core businesses which are not ESG compliant.

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