Welcome to Alston & Bird's third quarterly update on the secondaries market. In this issue, we share insights on SFDR, ESG, diversity, and the emotions of PE.

INSIGHTS – SUSTAINABLE FINANCE DISCLOSURE REGULATION

This quarter's insight is provided courtesy of **Rosemary McCollin of Vistra UK**: ESG has been a trending topic for years as public concern over climate change, social inequities, and corporate accountability mount in countries around the world. Consumers and investors in virtually every industry, including private equity, are increasingly demanding that their vendors meet ESG criteria. New regulations, such as the EU's Sustainable Finance Disclosure Regulation (SFDR), have only increased the commercial importance of ESG. The SFDR is part of the larger EU Sustainable Finance Action Plan. At its heart, the aim of the SFDR is to provide the required clarity and enable end investors to make informed decisions about sustainability between service providers.

Under level one of the SFDR, which applied from March 10 this year, funds have to be classified as sustainable funds (under Article 9), partially sustainable (under Article 8), or not sustainable/out of scope (under Article 6). All of this must be clearly disclosed to investors; the regulations cover pre-contractual disclosures and disclosures in reports, websites, and marketing communications. While this clearly appears to be beneficial for investors, it provides a particular challenge for managers who need to determine which article they should be placed under.

Critically, there is still much that needs to be confirmed regarding the full extent of the regulation because this is only the level-one phase. Notably, it is uncertain whether managers will be able to change their classification at a later stage if they decide to.

At this stage, it is a case of playing a waiting game to see the level of disclosure and transparency that managers reach. This is unlikely to become clear until January 2022, when level two of the SFDR is due to come into force. This will require much more stringent disclosure from managers and is yet to be finalised. The rollout of this entire piece of regulation will likely run through the end of 2022, and potentially beyond that. It is crucial, therefore, for managers to take the right approach now and build strong foundations for the future. Getting the interpretation and implementation of the SFDR right will be key for compliance and the running of business going forward. Click here to read more.

MARKET SNAPSHOT

This quarter's market snapshot is provided courtesy of **Campbell Lutyens**.* With 2021 numbers yet to be finalised, we consider five key takeaways from the first half of the year:

1. 2021 is on track to exceed 2019's record volume of $85 billion as mid-year transactions reached approximately $50 billion. Buyers were fueled by strong tailwinds, including a sharp economic recovery, soaring public markets, and a booming primary market.

2. Pricing for LP fund interests is strong, with approximately two-thirds of positions sold in H1 2021 trading at a 10% discount or better. Demand for LP interests rebounded from distressed levels in 2020, when only a little more than one-third of fund positions sold at prices better than or equal to a 10% discount.
3. GP-led transactions have achieved a higher volume in the first half of 2021 (approximately $28 billion) than in *any full year before this*. Successful secondary transactions from name-brand sponsors have led to broad adoption of GP-led initiatives as an alternative exit path for strong-performing portfolio companies.
4. Tighter transaction pricing for GP-led deals was a hallmark of H1 2021 as over 90% of respondents reported that their average purchase price as a percentage of NAV was at or better than a 5% discount to NAV, and essentially no respondents reported discounts below 15%.
5. Buyers are highly optimistic about the full year's deal flow – 88% of those surveyed expect transaction volume to reach over $80 billion and over 40% expect volumes to reach over $100 billion.

** Campbell Lutyens's analysis is based on proprietary data gathered from a survey sent to more than 100 of the largest and most active participants in the secondary market.*

ESG, DIVERSITY, AND THE EMOTIONS OF PRIVATE EQUITY

ESG and Diversity

ESG may have once felt like a nice-to-have checkbox for socially focused organisations, but the tide has been turning – particularly in the private equity sphere. Firms are quickly realising that integrating ESG into their organisation and investment strategies is simply good business. Not only can an ESG-led investment strategy result in better risk-adjusted returns and a competitive edge but it can also satisfy investors needing to justify investment or looking for funds with ESG reporting alongside revenues. Rather than viewing ESG simply as an expense, it is now seen as an intelligent investment as well as an opportunity to prepare for compliance obligations down the road.

We recently spoke with **Matilde Horta e Costa of Arcano Partners**, who openly discussed the challenges of advancement for women within the industry. She explained that progress has generally been made in hiring a diverse workforce at the junior level, but the underlying problem is that of retention because many women tend to depart at the mid-level. These are deep-rooted societal trends and behaviours that will take time to change. So what can the alternative assets industry do? We work in a fast-paced environment which often leaves limited time for family life or other commitments, although the pandemic has certainly shifted the focus towards a better work-life balance. Firms have changed their policies in recent years, offering men to take paternity leave, and this has certainly helped towards levelling the playing field, but there is still much more to be done. In Matilde's view, we need to focus more on encouraging an open dialogue and active collaboration between men and women to support initiatives on diversity. Only then will real change be seen.

Emotions of Private Equity

We are now living in a post-lockdown world with very high levels of activity within the secondary market. We caught up with **Mark McDonald of DWS** and discussed the importance of reconnecting in person with fund managers, investors, and clients alike. Private equity is inherently a long-term asset class where personal relationships are fundamental. Most funds have a life span of 10 years or more, and relationships have to withstand the test of time, as well as market cycles and pandemics. We do not often speak of the emotions involved, but the truth is that personal interaction has greater significance compared to other areas of finance. Economics will always be the fundamental driver, but equally, investors need to have an instinctive faith in the sponsor or partner. The value of trust, credibility, and the good-old 'eyeball test' cannot be underestimated. In fact, gut-feeling, as noted in 'Rational or Emotional? The Real World of Private Equity', a research report co-authored by DWS, has been deemed the 'most underrated tool' in private equity. The recent global crisis has had a huge impact on PE firms and their companies, increasing anxiety and pressure on firms and individuals alike. We are all now re-emerging, attempting to re-establish and cement relationships forged during lockdowns (courtesy of Zoom). A timely reminder of the pivotal role that raw emotions play in investment decisions, in particular as we all face further uncertain times ahead.

OPEN FORUM

In our third Open Forum episode, **Alston & Bird's Lydia Rachianioti** talks with **Dr. Christina Benetou** about the importance of perspective. In a highly stressful career, Dr. Benetou must often prioritise her work based on matters of life and death, putting the other stressors of life into perspective. Listen to her story here of working through a pandemic, how science creates hope, and where she turns when challenges overwhelm.

Secondaries Update is produced by Alston & Bird's Financial Services & Products Group and is edited by Saloni Joshi, Rob Davidson, and Megan Lau.