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2025: What's on the Radar for Financial Institutions?

Introduction

> The financial sector's challenge isn't simply to keep pace with rapid change but to stay ahead.

Emmanuel Hadjidakis
Chair – Global Financial Institutions

In 2025, geopolitical events, technological advances, and regulatory developments will drive continuous transformation.

Governments are increasingly using financial sanctions to achieve foreign policy goals, ramping up enforcement.

Emerging technologies are introducing innovative financial products, promising productivity gains while creating new vulnerabilities.

New regulations aim to govern these technologies and, for example, control third-country access to financial markets, and strengthen prudential rules. Sustainability regulation continues to develop albeit subject to regional divergence.

In alternative finance, after a slow 2024, pressure is building for divestitures, while sponsors seek new fundraising. Private debt investors are focusing on resilient industries with good creditworthiness.

Tax remains an area to watch as governments target large businesses, private equity, and high-net-worth individuals to close revenue gaps, with increasing tax transparency measures and new OECD rules.

Financial institutions must not only manage these risks but also seize the opportunities. Join our experts as they explore what 2025 holds for the financial sector.

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Baker McKenzie's global reach, strong connections with regulatory authorities, and experience make us the ideal adviser to guide financial institutions through the panoply of issues in a rapidly changing environment.

Contact us today to discuss your concerns:

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Key Takeaways

Until recently, the incoming tide of sustainability policies has seemed inexorable. Now, higher interest rates and prices, generally tougher economic conditions and changing political sentiment appear likely to slow or reverse current policies.

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2025 will see sustainability-related litigation and enforcement emerge as one of the predominant disputes concerns for financial institutions.

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The importance of transition plans will continue to grow as sustainability due diligence and disclosure requirements increase in many jurisdictions.

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The financial sector is nowhere close to realizing the benefits artificial intelligence can bring to businesses and to customers. Nonetheless, most generative AI use cases identified to date remain under testing or in beta environments.

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We will see increasing interest from financial institutions in tokenization use cases. However, there are legal implications and other obstacles to be mindful of, such as scalability and interoperability.

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2025 could be the year that crypto assets achieve respectability as regulators are forced to accept (albeit reluctantly), this new asset class into the regulatory fold.

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The quickly changing sanctions landscape, especially in the wake of geopolitical events, such as the war in Ukraine, means that banks and financial sponsors alike need to be vigilant.

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The complexity and scale of cyber threats continue to grow, posing risks to operations, reputation and customer trust. The growing power of AI and the risks posed by a future technology, namely quantum computing, threaten to further augment the risk of cyberattacks.

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The repercussions of the #MeToo movement across society are leading to an increase in allegations of nonfinancial misconduct in the financial sector.

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As governments continue to look to large businesses to close revenue gaps, we anticipate a continued increase in proactive tax authority challenge across the globe and across all areas of corporate income taxes, transfer pricing and indirect taxes.

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In private equity there will be an increased focus in 2025 to perform quick and reliable restructurings to achieve exit readiness. Meanwhile, private debt investors will continue to focus on investments in resilient industries which provide good credit worthiness.

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In funds finance, large global banks have dominated the market for subscription credit facilities and have also led the way in providing net asset value (NAV), hybrid and other fund financing facilities, such as general partner (GP) facilities and management facilities. However, institutional investors are becoming increasingly active in the market, and this has led to more competition.

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Life for local branches of non-EU banks in the EU is about to get harder under CRD6. One obvious winner, already lightly regulated compared to banks, is private credit that falls outside CRD6 and remains subject to national rules.

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There are barriers to increasing private funding for adaptation finance, but if overcome, there is tremendous potential with the right tools and financial products.

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The disappearance of Credit Suisse poses new challenges for the banking industry worldwide. The main question is what instruments should a regulator have available in its toolkit to be able to react earlier and more effectively and also preventively?

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Sustainability

Sustainability trends

In recent years, the incoming tide of sustainable finance has seemed inexorable. The EU, with its European Green Deal, is in the vanguard, most recently approving a regulation on ESG rating activities. Change is afoot, however.

The EU, the US and the UK are all seeing changes in their leadership. A new European Commission took office in December 2024 and has promised to focus on the implementation of and investment in the European Green Deal, while curbing "red tape" in its regulatory framework.

On the other side of the Atlantic, the Trump administration is expected to see a rollback of many sustainability and climate regulations. Next door to the US, Canada may also see a change in government and policy later this year. In the UK, the Labour government elected last summer promised to enhance sustainability regulation and has ambitious targets for renewable energy and carbon reduction. Nonetheless, its emphasis on promoting economic growth will likely color its approach.

Recent economic headwinds have made many governments more cautious in their pursuit of net-zero emissions to avoid placing extra costs on businesses and consumers. Measures to simplify and consolidate rules for businesses are illustrative of the EU's approach. Discussions around "omnibus" legislation, which is meant to consolidate rules for corporate reporting and due diligence, pursuant to the Corporate Sustainability Reporting Directive, the EU Taxonomy and the Corporate Sustainability Due Diligence Directive, have started with more concrete proposals likely to be published at the end of February 2025.

In parallel, the EU also plans to improve the working of the Sustainable Financial Disclosure Regulation that mandates disclosures around the sustainability characteristics of financial products. It is possible that in the process, we may see certain sustainability targets eased. It is possible that in the process, we will see rising pressure on the EU to ease sustainability target.

In the US, leaving aside the arrival of new administration appointees to the Securities and Exchange Commission and Environmental Protection Agency, these agencies' rulemaking powers have already been diminished.

In June 2024, the Supreme Court overturned the Chevron deference doctrine curtailing the power of federal agencies to interpret ambiguous legislation, such as on climate and environmental matters. Of even greater interest are plans to repeal significant elements of the US Inflation Reduction Act, especially those that concern climate and clean energy investments, including tax credits and other incentives.

Eva-Maria Ségur-Cabanac
Partner

It is possible that we will see rising pressure on the EU to ease sustainability targets

Ironically, this comes at a time when both the European Commission and the UK government are looking to channel investment into infrastructure and green energy aided by public money. The EU has the Clean Industrial Deal, while the UK has its Green Prosperity Plan. The latter is said to be integral to the UK's economic growth agenda and envisages that in partnership with the private sector, a National Wealth Fund will make "transformative investments" in infrastructure and clean energy. Therefore, 2025 will see more complexity and greater variance in sustainability policy across jurisdictions.

Sustainability-related litigation

The potential for litigation and regulatory action over sustainability concerns is growing. For instance, regulators and nongovernmental organizations are bringing more greenwashing claims and litigation concerning due diligence failures on environmental matters and human rights. In addition, climate change litigation continues to spread to new countries as reflected in the sixth annual Grantham-Sabine report on climate change litigation.

Moreover, while cases against businesses have focused on the fossil fuel sector, they are now being brought against other sectors, such as financial services.

Sustainability

We expect that 2025 will see such claims emerge as one of as the predominant disputes concern for financial institutions. Claims can be grouped into broad categories. First, there is disclosure-based litigation for businesses said to have made false or misleading claims about sustainability-related issues. This category also includes regulatory investigations into greenwashing that can lead to follow-on civil litigation.

Then there is conduct-related litigation, such as class action mass tort litigation, exemplified by the US, where a community is affected by a financial institution's activities. Strategic litigation is another. This involves claims brought to influence a lender's strategy, such as turning off funding for controversial projects. Claims may also be brought based on an alleged breach of directors' duties to protect a business and its assets from climate transition risk. Finally, there is an increasing amount of contract litigation around Sustainability-related clauses in commercial contracts, such as warranties and indemnities.

Peter Tomczak
Partner

"In the US, we expect to see more claims against the sustainability investment policies of banks and asset managers.

Looking ahead, factors tending to contribute to increased litigation, include newly established corporate due diligence laws and civil liability regimes (for example, the French duty of vigilance law) and from 2027, the EU Corporate Sustainability Due Diligence Directive.

Additionally, increased mandatory and voluntary disclosures by corporates relating to sustainability-related issues provide an evidence base for potential litigants and a heightened risk of inaccuracies in such disclosures. In the US, we expect to see a growth in claims against the green investment policies of banks and asset managers, which will be tolerated if not encouraged by a new federal administration.

Federal agencies may bring actions not necessarily to enforce standards but to hold businesses responsible for inflated representations to investors, such as over investments in renewable energy projects and carbon credits.

All this shows that mitigating the underlying risks is more important than ever. There are practical steps that businesses can take – most importantly, in verifying all sustainability, environmental, social and governance claims and ensuring transparency around external disclosures – to both reduce the risk of litigation and/or regulatory enforcement and to enable a prompt, strategic and coordinated response should claims appear.

Transition plan adoption

The headline news last year on the EU's Corporate Sustainability Due Diligence Directive (CSDDD) was the partial exemption of financial institutions from its terms, but the real story is the increasing importance of transition plans whose role will only grow in 2025.

On the one hand, the financial sector was exempted from the environmental and human rights due diligence duty on their "downstream" activities, such as loans and finance. On the other hand, larger in-scope entities must adopt climate transition plans to show how they are mitigating their impact on global warming.

Currently, the EU Corporate Sustainability Reporting Directive requires in-scope businesses to disclose whether they have a plan or explain why they do not have one. In contrast, starting 2027, the CSDDD will require the adoption of a plan and "best efforts" to achieve the Paris agreement-aligned targets it contains.

This new legislation, then, will drive larger companies to adopt transition plans (and pressure smaller businesses to follow suit). It is not only relevant to EU-based entities because third-country businesses with a net turnover in the EU of more than EUR 450 million will also have to comply with the legislation.

Additionally, and specific to credit institutions to manage micro-prudential risks, the EU Capital Requirements Directive will require the use of transition plans starting in 2026 to address ESG risks. Such plans will focus on ensuring their prudential strength as the economy transitions to mitigate climate change.

Sustainability

How supervisors approach implementation will be important given the potential implications for the cost of capital. All of this reflects a growing international momentum on the uptake of transitions plans and their regulation. Reflecting the position in the EU, the UK requires listed companies and large regulated asset owners and asset managers to disclose transition plans on a comply-or-explain basis. A plan will soon be compulsory. Moreover, the UK's Transition Plan Taskforce has sought to develop standards (with guidance) consistent with those developed by the International Sustainability Standards Board to facilitate their uptake.

Other countries that are active in this space include Australia, Brazil, China, Japan, Malaysia, Singapore and Switzerland. The position is typically more complex in the US. The Securities and Exchange Commission's Climate Disclosure Rule, which would have required public companies to disclose their transition plans, was stayed in 2024 due to multiple lawsuits and will not go any further.

William-James Kettlewell
Counsel

The real story is the increasing importance of transition plans, whose role will only grow in 2025.

But that's not to forget the US Treasury's 2023 principles to help financial institutions set net-zero financing and investment goals. While the new US administration and the next SEC chair are likely to retreat from policy in this area, there remains considerable investor demand for climate-related information from businesses, many of which are already providing such disclosures. Thus, companies that conduct cross-border business may have little choice but to adopt and implement transition plans, wherever they may be based.

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Fintech/Digitalization

AI and machine learning

Artificial intelligence and machine learning have been used in the financial sector for a decade or more. Portfolio optimization has benefited enormously from AI, as has fraud management. The arrival of generative AI has provided a massive boost to AI's use across all sectors of the economy, but especially in the financial sector, which can draw on its longstanding experience.

According to Statista, it is estimated that in 2023, a whopping USD 35 billion was invested in AI, with banks responsible for two-thirds of this sum. This reflects the tremendous potential that the technology offers, whether through innovative products and services or cost-saving efficiencies.

Vinod Bange
Partner

AI will likely permeate every facet of financial services provision within the next five years.

Moreover, financial institutions are especially cautious in their adoption of innovative technologies given the burdensome regulatory environment in which they operate and the risks to which they are exposed if outcomes are not as expected. Such concerns include fairness (e.g., data bias), respecting intellectual property rights and the need to provide for contestability and redress.

While care is needed over the customer experience and outcomes, AI use can increase the vulnerability of firms' systems and controls to threats, such as cyberattacks and other data incidents. Its adoption, however, is also a crucial part of mitigating cyber risk.

More positively, to date, regulators internationally are content to supervise AI within existing principles and rules – although for the wider economy, many countries are introducing specific AI laws.

Some of this legislation, particularly in the EU and a vetoed measure in California, have raised concerns that it may stifle the development of AI.

While this is something to watch in 2025, we consider that the regulatory environment will continue to remain positive in financial services, especially with the approach of the new US administration.

Supervisors are supportive of AI adoption through guidance and the establishment of sandboxes for testing. Moreover, they continue to apply a technology-neutral approach to supervising AI and the risks that may arise, rather than a more onerous approach. Nonetheless, the sector is right to be cautious over deployment and will want to focus on robust risk and control frameworks to protect customers and markets.

Generative AI is proving capable of summarizing research and due diligence, as well as writing technical documents, such as on financial, environmental, social and governance topics. AI will likely permeate every facet of financial services provision within the next five years.

The sector is nowhere close to realizing the benefits it can bring to businesses and customers. It fair to say that most generative AI use cases identified to date remain under testing or in beta environments. Naturally, technology must be developed and tested satisfactorily before it can be deployed.

Tokenization

The Bank for International Settlements has a "vision of an ecosystem where assets from an enormous variety of classes are tokenized, allowing them to be seamlessly exchanged for tokenized versions of cash without settlement delays and the risks and costs they entail."

As this statement indicates, there are two main use cases for tokens: tokenized investment funds where units in a fund are digitally represented and can be traded and recorded on a distributed ledger; and tokenized deposits that represent claims on fiat currency deposits enabling faster and more secure payment transactions.

A recent report from the European Banking Authority confirms that account-based models resemble most conventional deposits recorded on traditional bank ledgers, while a model with directly transferable deposit tokens requires a more detailed assessment.

Fintech/Digitalization

Tokenization brings benefits. These are cost and efficiency, a "unified ledger" 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.

Then there is programmability through smart contracts and, due to the use of blockchain, improved compliance, auditability and transparency.

While tokenization has been around since the 2010s, its adoption has been relatively slow. Why, then, is this a technology to watch in 2025? More regulation is starting to apply, such as the EU's Regulation on markets in crypto assets (MiCAR), which focuses on stablecoins and other unregulated crypto assets, and the US Securities and Exchange Commission is likely to be more supportive under a new chair.

Crucially, there is also support from financial regulators as financial institutions are understandably cautious in such an intensively regulated sector.

Conrad Ruppel
Partner

“ Despite increasing regulatory developments, the legal analysis of tokens is still in its early stages and very dynamic.

This is exemplified by digital sandboxes and industry initiatives, such as Project Guardian, which saw the issuance of Singapore dollar deposit tokens by an investment bank for an FX transaction on a public blockchain. Another example is the small but rapidly growing USD 800 million market in tokenized bonds in Europe.

Unsurprisingly, therefore, we are seeing increasing interest from financial institutions in use cases. But there are legal implications and other obstacles to be mindful of. Although technological solutions may seem to operate autonomously, they need the backstop of law to provide legal certainty.

Yet, despite increasing regulatory developments, legal analysis of the nature of tokens is still in its early stages and very dynamic. Among other issues, there is the risk of loss, fraud, illegal transfer and, where most transactions have a cross-border element, complications over conflict of laws.

A further practical obstacle reflecting tokenization's nascent development are limitations around the available infrastructure. These include scalability, interoperability between systems, integration with existing systems and, perhaps most important, the need for extensive development and testing to prove the degree of reliability and resilience expected by financial markets.

Crypto assets

2025 could be the year that crypto assets achieve respectability as regulators are forced to accept (albeit reluctantly) this new asset class into the regulatory fold.

After years of being kept at arm's length by traditional financial institutions and following a low point of market collapses in 2022, crypto is beginning to gain at least acquiescence, if not enthusiastic acceptance. Indeed, ownership of crypto is rising year on year globally, and while only a few financial institutions currently provide access to crypto products and services, more plan to do so in the future. They are increasingly engaging in digital assets testing and looking to see how to integrate them into their services.

That this has come about is, in part, due to the resilience of crypto market players and the willingness of investors internationally to engage in the face of regulatory hostility. In fact, it took litigation to force the US Securities and Exchange Commission to approve the listing and trading of spot bitcoin exchange-traded product shares. Even then, it remained unwilling to approve crypto asset securities themselves, and other litigation is still ongoing.

The new US president has promised to make the US "the crypto capital of the planet," which means the new administration should be more receptive to digital assets.

There will even be a White House crypto-tsar and council to help push market regulation in the "right" direction. It looks as if the US Commodities Futures Trading Commission will prevail in the new Congress as the lead regulator, so the sector may expect a lighter form of supervision.

Fintech/Digitalization

The change in direction in the US is of course notable given the size and importance of its markets, but developments elsewhere are also relevant. The EU's Regulation on markets in crypto assets (MiCAR) covers certain crypto assets, their issuance and entities providing crypto asset services.

Its authorization framework for service providers will apply in 2025, and this regulatory endorsement is generating confidence in the sector from traditional financial institutions and growing interest generally. The allure of economic growth that crypto promises has caught the attention of other jurisdictions.

In the UK, where the regulator has been criticized for its aversion to risk, the government has confirmed proposals to develop the sector, emphasizing its wish to see regulation that facilitates growth. In the meantime, other jurisdictions have not stood still. Dubai, in the UAE, has recently upgraded its rules to further strengthen its crypto-friendly reputation.

Kullarat Phongsathaporn
Special Counsel

2025 could be the year that crypto assets achieve respectability.

In Asia, Thailand, one of the first jurisdictions to regulate crypto, has a government supportive of the sector's development and recently granted a tax exemption for crypto users. Singapore is an important center with a robust but progressive regulatory framework that supports innovation.

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Growing Regulatory Scrutiny

Sanctions

Since the end of the "US alone-led" world order, the last 20 years have seen increasing global instability characterized by high-risk geopolitical events. In particular, the growing use of financial and trade sanctions poses complex compliance challenges for financial institutions.

The quickly changing sanctions landscape, especially in the wake of geopolitical events, such as the war in Ukraine, means that banks and financial sponsors alike need to be vigilant. The US Office of Foreign Assets Control, which is responsible for US sanctions, lists some 38 active sanctions programs.

These range from the jurisdiction-specific to issues such as Magnitsky human rights, as well as cyber-related and transnational criminal organizations. Such measures are not static, with new restrictions constantly added and new entities and individuals designated.

The management of sanctions is complicated by the existence of parallel measures issued by different countries, such as the US, the UK and the EU. While they may be similar and have the same goal, their precise scope and exceptions may materially differ.

For example, US sanctions measures are the mostly extraterritorial in application, in that US jurisdiction is routinely imposed against otherwise offshore transactions that are settled in US dollars and that involve sanctioned parties or activities related to sanctioned destinations. To add further complexity and compliance risk, jurisdictions that are the subject of sanctions are adopting blocking legislation that also requires consideration, especially where a business has a presence there. 2025 will see a continuation of these risks even if there is an end to the Ukraine-Russia war.

Moreover, sanctions enforcement is likely to intensify, not only in the US but in Europe and Asia. For instance, the US continues to widen the application of secondary sanctions against non-US financial institutions that engage in "significant" transactions with designated persons. It is also bringing more enforcement against individuals who try to obfuscate and conceal sanctions evasion within businesses.

Export control compliance is a growing issue for financial institutions, with the US Commerce Department publishing compliance expectations for this sector and partnering with the US Financial Crimes Enforcement Network to encourage more reporting on financial transactions.

The UK, which has applied strict liability since 2022, has not only strengthened the enforcement capability of its Office of Financial Sanctions Implementation but flagged up its commitment to step up enforcement, both civil and criminal.

Janet Kim
Partner

Expect to see more litigation from sanctions-related disputes with counterparties.

Financial institutions must therefore be vigilant about identifying these risks by having the right systems, internal controls, transaction monitoring and testing in place to effectively screen transactions involving clients or their counterparties and implicating economic embargoes, designated persons or asset freezes.

Thorough risk-based due diligence on customers, investors, intermediaries and counterparties is essential. Added elements include a commitment from leadership and training programs. Robust whistleblower programs are another must. Separately, financial institutions should expect to see more litigation from sanctions-related disputes with counterparties; as such, the importance of reviewing terms and conditions for contractual protection is critical. It is important to have terms allowing proactive protective steps (e.g., to pause obligations or fulfil them lawfully by other means) where contractual performance may contravene or implicate significant risks under sanctions law.

Growing Regulatory Scrutiny

Cybersecurity – future risks

Cyber risk is a top issue for financial institutions that are data-rich businesses and where protecting customer information is paramount. Unsurprisingly, the sector is one of the most heavily targeted for cyberattacks, being the recipient of one in every four such attacks in recent years. The average cost of a data breach in the financial sector is close to USD 6 million according to data from Statista. The complexity and scale of cyber threats continue to grow, posing risks to operations, reputation and customer trust. Increasing global interconnectedness means attacks may come from anywhere.

Moreover, the trend toward digitalization (e.g., cloud services and digital transactions) provides a fertile environment for an attack. There are recent and numerous examples of cyber incidents on market participants that are not themselves large but can have a large-scale ripple effect on other businesses. For this reason, third- and fourth-party contractor due diligence is essential. Many breaches would have been prevented but for better cyber hygiene, such as properly carrying out risk assessments and deploying patches in a timely manner.

Jessica Nall
Partner

> Businesses should consider the cyber risks posed by future technology, namely quantum computing.

Against this backdrop, authorities worldwide are responding with exacting cyber and data regulation that is challenging to manage. Disclosure and reporting obligations regarding not only cyberattacks, but also cybersecurity readiness and governance, are becoming ever stricter.

In 2025, the sector will undoubtedly face ever more sophisticated cyber threats, regulatory pressures and technological advancements that will call for innovative and proactive steps by every level of management, from information security teams to the board of directors. The growing power of artificial intelligence, while offering financial institutions cost savings and efficiencies, as well as new products, also threatens to increase the risk of cyberattacks.

Whether this is through facilitating more sophisticated phishing attacks against employees to gain access to IT systems or overcoming sophisticated technological defenses, further resources will be needed to safeguard critical business operations. AI will itself be pressed into service to counter such attacks, requiring institutions to be nimble in understanding and employing new defensive tools.

While AI-enabled cyberattacks are a clear and present danger, businesses ought to begin considering the risks posed by future technology, namely quantum computing. Again, while it is very much in development and offers transformative benefits in the coming decade, it poses a potential cyber risk now.

Financial information protected under current standards of encryption could be vulnerable if exfiltrated now but accessed in the future using enhanced tools. This is because tomorrow's quantum computers could decode today's cryptographic algorithms that protect data.

Supervisors are advising financial institutions to review their vulnerabilities and put countermeasures in place to prevent data theft (and consider such thefts in new ways when they do occur) with this anticipated future capability in mind. The US National Institute of Standards and Technology will publish post-quantum encryption standards this year. Keeping abreast of current standards is a minimum requirement, to which staying vigilant about emerging and future risks should be added.

Nonfinancial misconduct

Alongside financial crime, market misconduct and other types of fraudulent conduct, financial institutions are facing another call on their resources. Awareness created through #MeToo and similar movements has resulted in an increase in reports and claims of nonfinancial misconduct in the financial sector and subsequent employee claims. These include allegations of bullying, sexual harassment and discrimination.

Growing Regulatory Scrutiny

This trend also reflects the importance placed by many regulators on inclusion, diversity and equity programs, together with the governance limb of ESG concerns. These are driving efforts in the financial sector to strengthen psychological safety or "speak up" culture to call out improper behavior in the workplace, for instance, while more robust whistleblowing regimes are inspiring employees' greater willingness to report inappropriate behavior. This means that there is a steady but increasing flow of internal investigations and, to a lesser extent, litigation around such allegations.

Moreover, failure to properly investigate and adequately follow up on risks leaves businesses vulnerable to reputational damage should a matter become public at a later date and, potentially, to enforcement action by financial regulators for breaches of their rulebook.

In this respect, some jurisdictions are bringing new rules into effect. The UK has introduced a legal duty on all employers to take "reasonable steps" to prevent sexual harassment, while its conduct and markets regulator is introducing new policies. Such investigations tend not only to be resource-intensive — whether through HR or internal/external legal counsel — but disruptive to the functioning of the business. The South African legislature has introduced amendments to the Code of Good Practice for handling such claims with a firm link between harassment and discrimination.

A further complication is that the boundaries of what amounts to nonfinancial misconduct for activities outside the professional sphere are not always easy to discern. Given these facts, in the future, leadership in financial institutions must strengthen still further their corporate efforts to promote good workplace cultures, ensuring that appropriate policies and procedures are in place and that allegations are promptly and fairly investigated and afforded due process.

Johan Botes
Partner

Awareness created through #MeToo and similar movements has resulted in increasing reports of nonfinancial misconduct sector and subsequent employee claims

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Asset Management and Financial Sponsors

Tax landscape

Asset managers and financial sponsors can expect further change in the international tax landscape in 2025. The continuing focus on the tax treatment of carried interest is a primary concern for the private market and presents contentious issues in tax policy across various jurisdictions. We may see whether a more coordinated approach begins to emerge, giving rise to a more level playing field.

As governments strive to balance fairness and competitiveness, private equity managers will need to stay informed about the latest developments and prepare for potential changes.

Fund managers and private equity executives who are internationally mobile may wish to move to regions with more favorable tax regimes. Private equity firms may also want to explore accelerating payouts in any jurisdiction where it might be possible to lock in current capital gains rates.

Embracing new ways of working following the pandemic has increased tax uncertainty. The risks relating to complex employment, payroll tax, social security, corporate income tax, substance and residency issues can leave businesses exposed to challenges by tax authorities.

We expect an increased focus at both an OECD and EU level on developing additional guidance and legislation in this area, with the hope that this will lead to more clarity and consistency.

As governments continue to look to large businesses, private equity firms and high net-worth individuals, to close revenue gaps, we anticipate a continued increase in proactive tax authority challenge across the globe and across all areas of income taxes, transfer pricing and indirect taxes.

This challenging environment is exacerbated by a significant addition in tax transparency measures and tax authority data interrogation tools, with the continued heavy investment in and increased use of AI. Businesses will also continue to focus on how tax touches all aspects of the sustainability agenda – from (E) environmental taxes/reliefs and climate transition plans, to (S) tax responsibility and (G) robust tax governance, transparency and reporting – alongside the expectation that the new US administration may continue to encourage the reversal of Biden-era green energy-based tax credits enacted as part of the Inflation Reduction Act.

As businesses transform on account of key sustainability levers, tax has a critical role to play from a risk mitigation/value creation perspective.

Daniel Cullen
Partner

A new baseline expectation around tax transparency for businesses is emerging.

Tax transparency is also in focus, in view of the new corporate sustainability reporting environment. A new baseline expectation around tax transparency for businesses is emerging. The dawn of EU public country-by-country reporting puts tax transparency on a legislative footing and is a significant shift in the business transparency landscape.

While the new OECD Pillar Two rules bed down in many jurisdictions, the new US administration has so far expressed unwillingness to cooperate with the OECD's approach.

We await the US government's response to other countries' implementation of the rules. Top-up taxes in other jurisdictions threaten double taxation for US multinationals, and a tax and trade conflict could result.

Alternative finance

Given that 2024 has not brought the desired push in dealmaking for private equity investors, pressure is now evident when it comes to divestitures. Sponsors need to generate cash to comply with distribution expectations from their limited partners, but they are they are looking for new fundraisings too.

Limited partners will only be willing to continue to provide funds to sponsors if they are comfortable that assets will be managed in a manner that results in the desired internal rate of return. There will be an increased focus in 2025 to perform quick and reliable restructurings to achieve exit readiness.

Asset Management and Financial Sponsors

At the same time, sponsors will be looking to make appropriate investments where opportunities arise. This will result in an increased deal flow where expectations in terms of multiples will become closer between the sell side and the buy side, though likely in a lower range than before.

Matthias Töke
Partner

Where good credit prospects hit the private debt market, competition will be fierce.

Upcoming financial restructurings will be complex, but they will provide opportunities for leveraged buyouts and carve outs from corporations that will shift focus on to their core business segments. In Germany, many businesses that are still family-owned will be restructured and brought into the M&A market to look for financial sponsors as partners. This will help drive primary deals.

Therefore, we anticipate increased pressure and complexity in the new year, and this will require legal expertise from different product groups, particularly financing and restructuring experts that have a deep understanding of legal structures and market developments.

Regarding private debt investors, they will continue to focus on investments in resilient industries that provide good credit worthiness. This applies to the software, medtech and certain business services sectors, but in any event, those with no (or only a little) connection to the automotive and consumer industries. Where good credit prospects hit the market, the competition between the private debt players will continue to be extraordinarily high.

Private debt investors will require legal counsel with specialist knowledge in market trends and terms to ensure that credit risk remains under control while they remain competitive.

Private debt investors will face the same challenges as private equity sponsors, as the number of restructurings will continue to grow as does the holding period of credit. In the worst-case scenarios, private debt funds are taking and will continue to take over keys, and they must prove their ability to manage business turnarounds as equity investors.

Fund finance

The fund finance market has seen tremendous growth in recent years. This is likely to continue in the coming year, and funds are expected to drive demand for a wider and more diversified range of liquidity solutions to meet their funding needs.

Fund finance refers to financing products provided to private markets funds, including private equity, private credit, infrastructure and real estate funds, to meet their funding needs throughout the life cycle of the fund. The most well-known fund finance product is a subscription credit facility, which is typically used by closed-ended funds for the purposes of, among other things, bridging capital calls from the investors in the fund during the first half of the lifecycle of the fund.

The fund finance market has developed other liquidity solutions for the second half of a fund's lifecycle (when it has drawn a substantial portion of its undrawn capital commitments and made a significant number of investments), such as NAV facilities, and whole lifecycle solutions, such as hybrid facilities. These products are becoming more prevalent and drive significant growth in the fund finance market.

As the fund finance market continues to grow, financing structures have become increasingly complex, with greater leverage being deployed, and increasing demand from funds for bespoke financing solutions. This is expected to continue and result in more innovative and highly tailored products, particularly in the context of NAV and hybrid facilities, but also around subscription credit facilities, with an increased demand for sustainability-linked subscription facilities.

Asset Management and Financial Sponsors

Large global banks, and significant regional banks across the US, Europe and Asia, have dominated the market for subscription credit facilities, largely because these facilities are revolving credit facilities and are considered a relationship product. These banks have also led the way in providing NAV, hybrid and other fund financing facilities, such as GP facilities and management facilities.

However, institutional investors are becoming increasingly active in the market, especially for NAV facilities, which tend to be structured as term-loan facilities. This has led to more competition, and, when coupled with a focus from banks on regulatory capital requirements and loan distributions, is driving a debate in the fund finance market on the provision of ratings for fund finance products, which have traditionally not been rated to any significant degree.

There are challenges to overcome, but progress is being made and this is expected to be an area of significant focus for lenders this year.

From the perspective of funds as borrowers of fund finance facilities, the increasing use and complexity of fund finance facilities 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.

Ian Roebuck
Local Principal

The increasing complexity of fund finance is likely to face growing scrutiny from fund investors.

This focus by investors means that transparency and early communication by funds with their investors is becoming even more important in protecting an ongoing relationship, not just on contractual and regulatory grounds, but from an investor relations perspective.

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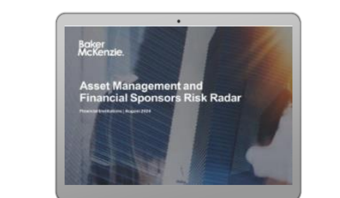

Global banks

Non-EU bank branch rules

Life for local branches of non-EU banks is about to get harder. Starting 2027, under the new EU Capital Requirements Directive (CRD6), member states will need to apply minimum authorization, prudential, reporting and supervisory requirements to local branches of non-EU banks.

Currently, each member state sets its own rules under which non-EU bank branches can operate, and many do not regulate commercial lending. The ability to conduct cross-border business elsewhere in the EU will therefore be further limited.

This step change in policy will likely hinder the provision of agile cross-border financial services into the EU, especially impacting the commercial lending market. Under CRD6, banks (and investment firms) established in third countries must set up a branch and seek authorization in each member state where they offer banking services.

These include deposit-taking, lending (understood in the broadest terms), as well as guarantees and commitments. Minimum regulatory requirements will apply, and where a non-EU bank's home country (e.g., the UK) is not assessed as equivalent, more onerous rules may still apply.

Further, member states remain free to apply more robust standards, in other words to engage in "gold plating." Nor will an EU passport be available to the branch for cross-border business. Under certain circumstances, member states will be able to require branches to subsidiarize, or they may elect to do so themselves to benefit from EU passporting rights once authorized.

Of course, such a step is not to be taken lightly and will require the new entity to be separately capitalized, which will affect the cost of capital within the bank as a whole. It will likely only be worthwhile where significant levels of business are transacted and thus will disadvantage mostly smaller market players to the detriment of competition and innovation.

Non-EU banks may choose to rely more on "reverse solicitation" to provide banking services, but this path needs to be trodden carefully should local regulators take issue.

Carlo de Vito Piscicelli
Partner

With private credit falling outside CRD6, it may receive a boost to its market share.

Similarly, a banking service may be exempt if it is ancillary to a MiFID core activity (e.g., where a non-EU prime broker extends credit associated with the trading of securities by EU hedge funds), provided, of course, that it follows MiFID's reverse solicitation provisions.

One obvious winner, already lightly regulated compared to banks, is private credit that falls outside CRD6 and remains subject to national rules. Will this perhaps further boost the growth in relationships between banks and private credit funds?

Adaptation finance

Adaptation finance supports people, businesses and countries in adapting to the impact of climate change. There is currently a significant gap between the amount of climate adaptation finance available and what is needed.

According to the Global Centre on Adaptation and the Climate Policy Initiative, finance for adaptation purposes needs to increase fourfold, while the sums currently provided by the private sector are modest. There are barriers to increasing private finance, but if overcome, there is tremendous potential with the right tools and financial products.

These barriers include a lack of common market language, standard definitions and a classification framework. There can also be a lack of detailed information on climate risk relevant to specific projects that can obscure its environmental benefits.

Another issue arises from relatively long timelines as institutional investors and commercial banks need to see a return within a reasonable timescale. All this can make it difficult to properly price and calculate risk and return.

To address these issues – some are more perceived than actual – a range of measures is necessary, from greater support from governments and use of standardized approaches, to more disclosure and reporting of information relevant to financing projects. A better understanding of the opportunities and the potential to achieve a commercial return is of course fundamental.

James Tanner
Partner

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Debt-for-impact swaps are now a tried and tested model in climate adaptation finance.

One promising funding method involves debt-for-impact swaps where there is great potential for growth in the future. Under such swaps, a sovereign debtor (whose debt is trading at a discount) repays existing debt via an issuance at or near par of a lower face amount, with a part of the savings going to finance climate adaptation projects.

This is possible as the new bonds benefit from political risk insurance and a development bank guarantee, meaning they are issued on more favourable terms than the existing discounted debt.

While this is now a tried and tested model, it depends on credit support provided by multilateral banks and development finance institutions, which have limited capacity.

As the market develops, we should see private finance stepping into these roles in the future, providing insurance and guarantees and thereby ramping up the potential number of transactions.

Bank-run protection

The world of Swiss banking is still dealing with the fallout from the disappearance of Credit Suisse. From an economic standpoint, this loss has not yet been fully absorbed.

The consequences will only become apparent in coming years, likely to be marked by a lack of competition in the Swiss market and resultant criticism of the situation. The US regional banking crisis in 2023 is also said to be an accelerant for the collapse of Credit Suisse.

Although the US local banks had little in common with Credit Suisse, which was robustly capitalized, that bank run spilled over. It was not the fast-spinning media that led to its swift demise, rather it was the unwelcome realization that bank runs do not stop at the doorsteps of even the best-capitalized banks.

This raises questions over the value of regulatory capital requirements. Will this then, reignite the debate on major regulatory banking issues such as capital adequacy, Too-Big-Too-Fail regulation and the implementation of stabilization measures?

In the end, according to a report by the Swiss regulator, FINMA, it was inadequate corporate governance that caused the bank to fail; Credit Suisse lost the confidence of its clients, investors and the markets due to repeated scandals and management errors.

The disappearance of Credit Suisse also poses new challenges for the banking industry worldwide. The main question to answer is what instruments should a regulator have available in its toolkit to be able to react earlier and more effectively and also preventively?

In its report, FINMA draws various lessons from the Credit Suisse debacle: it calls for a senior manager regime and the authority to impose fines as well as stricter corporate governance rules.

Global banks

This a discussion being held not only Switzerland, but in all major financial centers. Tighter rules are being drawn up, especially over corporate governance and regulatory intervention powers.

Supervisors increasingly want to know faster and, in more detail, what is going on within a bank. In future, it will be more difficult to investigate first internally and then decide whether to report to the regulator; that is before a bank has had a chance to form a clear understanding of an issue.

If so, this would provide an incentive not to initiate certain investigations in the first place – a Catch 22?

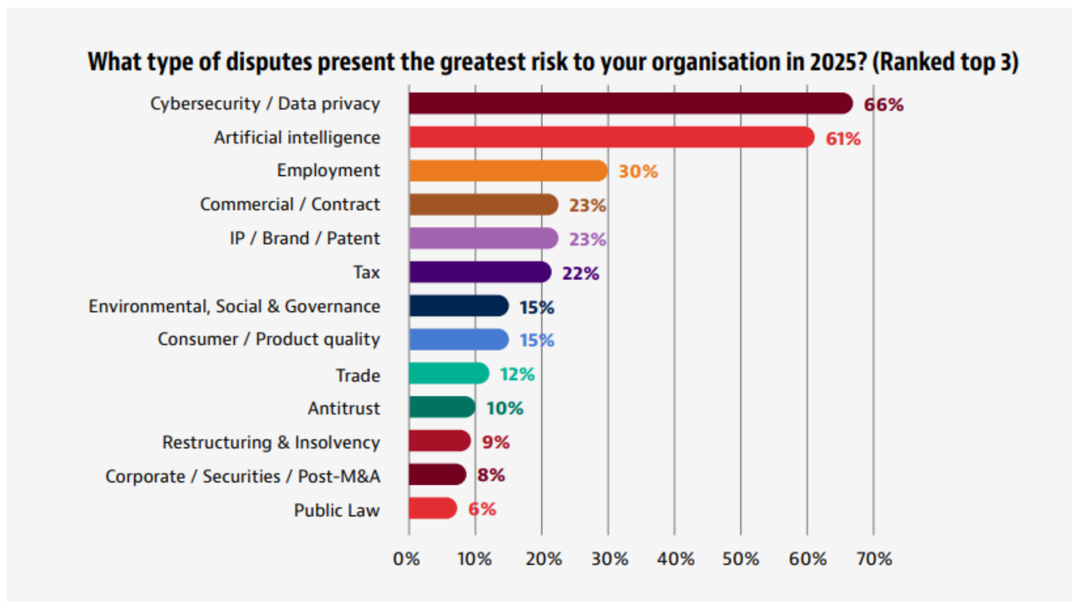
Ansgar Schott
Partner

Supervisors increasingly want to know faster and, in more detail, what is going on within a bank.

Baker McKenzie Global Disputes Forecast for 2025

Respondents from financial institutions were more optimistic in their disputes outlook than respondents in other sectors. More than a fifth of respondents predicted that their disputes spend would decrease in 2025.

These were their top concerns:



Find the full forecast at: bakermckenzie.com/disputeresolution

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