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**'DECODING'
THE SECONDARY
MARKET**



— THOUGHT LEADERSHIP

OCTOBER 2019

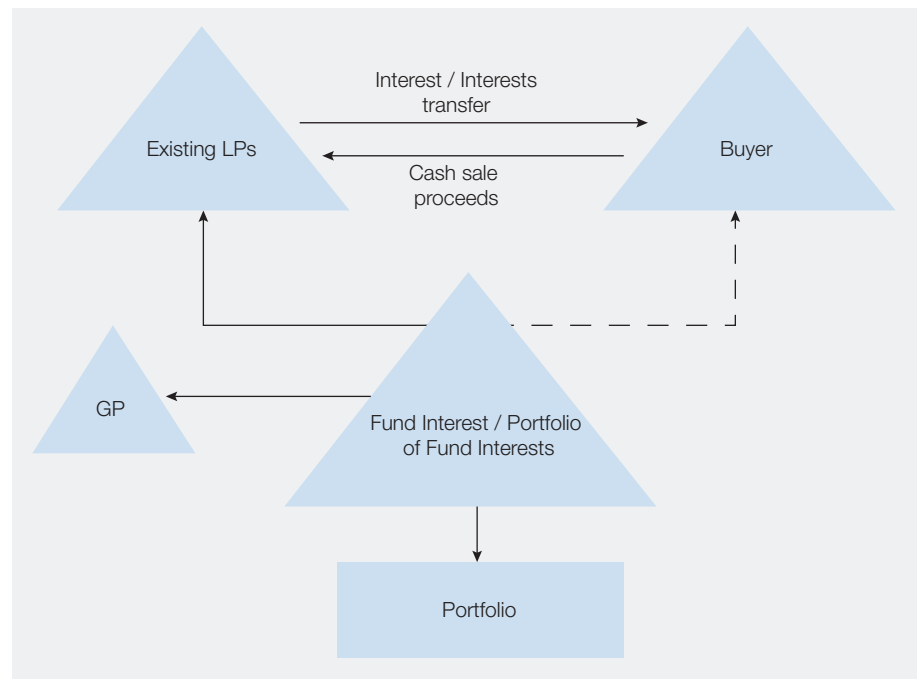


'DECODING' THE SECONDARY MARKET

We are seeing an unprecedented volume of activity in the secondary market, fuelled by record levels of fundraising by dedicated secondaries funds and an increasing desire by GPs and LPs to explore ever-evolving secondary transaction structures, designed to deliver value and liquidity solutions. Yet, the secondary market is still commonly misunderstood, owing to its inherent complexities and bespoke 'jargon'. The Clifford Chance Secondaries team 'decode' some secondary transaction structures below:

Secondary transactions: the "classic approach" traditionally a transaction that involves the transfer of ownership of a single LP interest in a private fund. The buyer will acquire the selling LP's interest in the fund's remaining assets and assume the selling LP's commitments to meet future capital calls.

Portfolio Interest Secondary: Involves the sale of a portfolio of interests by an LP to another investor. This allows LPs to manage their portfolios and GP relationships proactively and adapt their investment strategies as required by regulatory or strategic developments. Typically run as controlled action processes and generally require consent of each GP.



Hot Topics

- Due diligence/access to information on GP-led transactions
- Conflicts; ILPA guidance
- Use of warranty and indemnity Insurance
- Pricing Mechanisms
- Antitrust/regulatory approvals
- Carried Interest
- Governance



• **Secondary transactions “evolved” –**

GP-led secondaries: A sale process initiated by the GP, aiming to provide existing LPs with optional early liquidity. In its most basic form, a GP-led secondary involves existing LPs being given the option to sell all or a portion of their fund interests to the buyer during a binding election period. The fund continues with the buyer as a replacement LP.

Increasingly, the GP-led secondary ‘umbrella’ is used to cover a range of more complex secondary transaction structures, including continuation vehicle transactions and strip sales (see below).

• **Continuation Vehicle transactions:**

A form of fund restructuring which involves the transfer of assets by an existing fund to **Continuation fund**, typically managed by the same GP. LPs in the existing fund are given the option to cash-out or roll into the new, longer life fund. The purchase of interests from LPs who are cashing out is financed by subscription monies from new LPs, or existing LPs who increase their stakes.

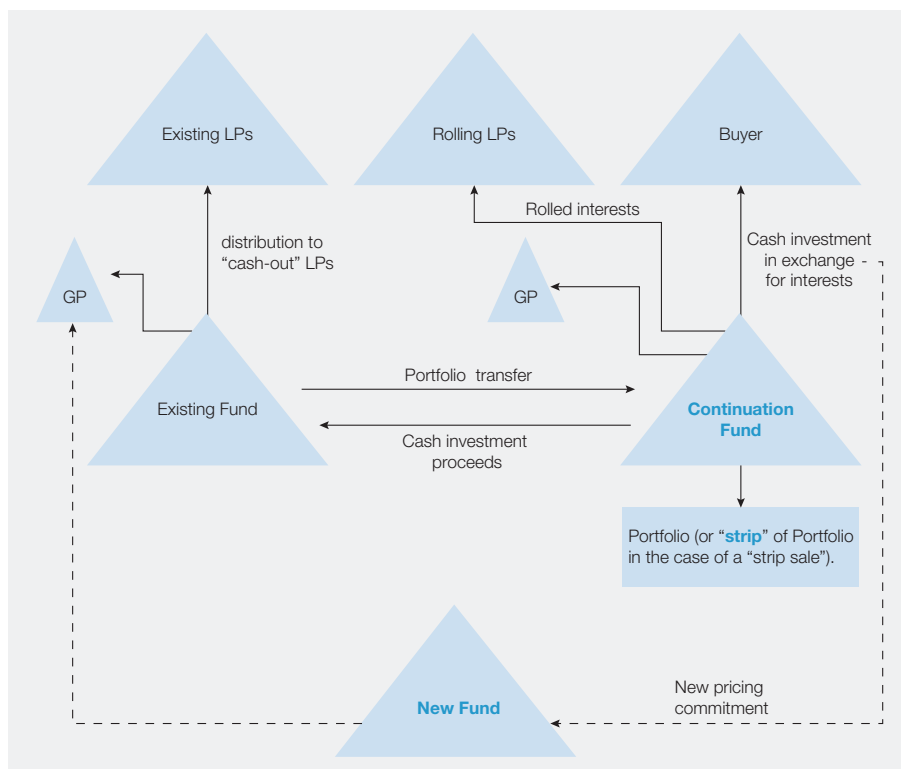
• **Strip Sale:**

A form of fund restructuring which involves the partial sale of a fund’s investment (**strip**) in all/some underlying assets to provide LPs with liquidity. This allows the fund to partially ‘lock-in’ any increase in asset values at the time of the sale, while still allowing the LPs to benefit from further upside via the fund’s retained stake in the asset(s). The GP typically has discretion to determine the **strip** percentage and/or asset selection.

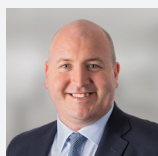
• **Stapled primaries:**

A hybrid transaction whereby the GP-led sale of interests in an existing fund to a buyer is concurrent with a primary capital commitment by the buyer to a **new fund** raised by the GP.

Conflicts of interest in relation to stapled primary transactions are a ‘hot topic’. There can be tension between (i) a GP’s fiduciary duties owed to LPs in the existing fund, i.e. to maximise value for LPs in the sale of interests in the existing fund to a buyer, and (ii) the GP’s desire to obtain capital from the buyer for a **new fund**.



CONTACTS



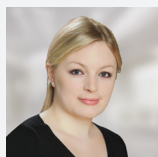
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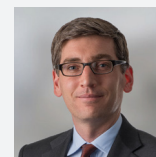
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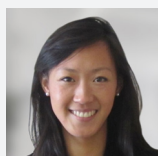
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