

CO-INVESTMENTS – KEY TERMS (PART 2 OF 2).

INDIRECT CO-INVESTMENTS

Unlike direct co-investments (discussed in our previous article, available [here](#)), where an investor is investing directly into the target asset and therefore has visibility over the terms of the transaction documents, indirect co-investments involve investing alongside the sponsor's main fund through a pooled vehicle managed by such sponsor. Indirect co-investments therefore require a different approach during the negotiation process, given that the co-investor's counterparty is not the target asset, but the sponsor itself. This means that the relevant documents to be negotiated are the constitutional documents of the pooling vehicle (including the LPA, subscription agreement and side letter). While these will largely be based on the relevant main fund's documents, there are important differences to bear in mind.

NO FEE, NO CARRY

Often the most important aspect for investors participating in a co-investment vehicle is for the investment to be on a "no fee, no carry" basis. Provided that the investor is already participating in the sponsor's main fund, the rationale is that the sponsor is already being compensated by way of the main fund's management fee and possible carried interest. Sponsors, on the other hand, may seek to justify some level of compensation to reflect the additional administrative burden and resource allocation required to structure and manage the co-investment vehicle. In the event such an administration fee is charged, this tends to be a fraction of the corresponding management fee charged at the main fund vehicle level.

This does not mean that investors will not be charged for organisational and operating expenses. Given that the investors' investment size on a look-through basis will be known from the outset, the required capital commitment for each investor can be apportioned accordingly. A buffer for expenses can then either be (a) built into the capital commitment, or (b) be charged in addition to the capital commitment. If the latter approach is adopted,

AT A GLANCE

- **Structural Distinction:** Unlike direct co-investments, indirect co-investments typically involve investing through a sponsor-managed pooling vehicle, shifting the negotiation focus from the underlying transaction documents to the constitutional documents of the co-investment vehicle.
- **Fee Expectations:** Investors typically expect to participate on a "no fee, no carry" basis, based on the rationale that sponsors are already compensated via the main fund. However, sponsors may seek modest administrative fees.
- **Pro Rata Alignment:** Investors push for "same in, same out" participation to ensure alignment with the main fund, while sponsors may seek flexibility due to timing, funding mechanics, or differing investment horizons.
- **Pre-emption Rights:** Follow-on investment rights are a key negotiation point, with investors seeking transparency and sponsors preferring flexibility over rigid allocation procedures.

investors will typically request a reasonable cap (e.g., 5% of the aggregate capital commitments).

PRO RATA PARTICIPATION

Another central area of negotiation is the “same in, same out” principle. To ensure greater alignment between the co-investment vehicle and the main fund, investors require that the investment be entered into and exited on a pro rata basis, at the same time, on the same economics and on the same other terms and conditions. Any flexibility granted to the sponsor with respect to this principle will typically be met with opposition by investors who fear that the co-investment vehicle may be disadvantaged vis-à-vis the main fund. Sponsors on the other hand may point to legitimate reasons for the co-investment vehicle not participating on a “same in, same out” basis. For instance, the main fund may have made the initial investment by using its existing subscription line, at which point the co-investment vehicle may not have existed. The relevant portion will therefore be syndicated to the co-investment vehicle at a later point in time and the co-investment vehicle may be required to pay interest for the interim period.

With respect to exits, investors are particularly concerned about the co-investment vehicle being stranded in an investment when the main fund exits. Investors are also concerned with cross fund sales, including to continuation vehicles, and request that these be carved out of the exit tag requirement. Sponsors may wish to retain operational flexibility and point to the co-investment vehicle and the main fund having different investment horizons and that co-investors may benefit from longer holding periods.

PRE-EMPTION RIGHTS

A closely related point that is often subject to extensive negotiation is pre-emption rights. Should any follow-on opportunity in or connected to the underlying asset be offered to the co-investment vehicle? What if the initial investment was in equity securities and the follow-on opportunity relates to its debt? As a result, it is common for investors to request clarity around the sponsor’s procedures for offering and allocating follow-on opportunities. Sponsors, for their part, may resist hard-wiring allocation processes into the LPA, preferring to retain flexibility to adapt to changing circumstances or commercial realities.

CONCLUSION

Negotiation of indirect co-investment terms is a highly nuanced and dynamic process, often reflecting the complex relationships between sponsors and their largest investors. Both investors and sponsors must approach the process with a clear understanding of their objectives and the differences between the main fund terms and those in the LPA of the co-investment vehicle.

If you would like to discuss co-investments, including their structuring, market terms, or explore how they fit within your investment strategy, please feel free to connect with us. Our team would be delighted to share our insights and assist you in navigating co-investments with confidence.

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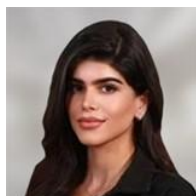
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