Clifford Chance

BRIEFING

CONTINUATION VEHICLES
Middle East

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Continuation vehicles ("**CVs**") and secondaries are not new concepts. However, the market for CV transactions continues to evolve and is becoming increasingly complex.

Key points

1. **Market Evolution & Innovation:** CVs have expanded beyond single-asset deals to include multi-asset, multi-fund structures, with added features like stapled commitments and even "CVs of CVs" (CVs2), blurring lines with evergreen funds.

2. **Status Quo Rolls & Tax Complexity:** The "status quo" roll-where rolling LPs retain similar economics-is a key tool for managing conflicts of interest, although true parity is rare. Structuring these rolls tax-neutrally across jurisdictions remains a significant challenge.

3. **Credit Fund CVs:** CVs are gaining traction in credit strategies, offering attractive IRRs and fewer transfer restrictions.

4. **CV Perception:** While, in the past, CV transactions were associated with more difficult assets, CVs today are mostly investing into "trophy" assets. Despite past scepticism, investor sentiment is maturing, with best practices like third-party fairness opinions and auction processes helping to address pricing and conflicts concerns.

MARKET EVOLUTION & INNOVATION

Previously the market had largely accepted CVs as solutions for single asset deals. Now, however, there is greater acceptance for new types of transactions, including CV transactions that involve multiple selling funds and multiple assets rolling into the same CV, as well as greater optionality for rolling LPs to participate in dry powder or stapled commitments. A new phenomenon we are increasingly seeing in the market is the rise of "CVs^2" – that is, a CV of a CV – which blends the boundaries between a CV and an evergreen fund.

STATUS QUO VS. RESET ROLLS

The concept of a “status quo” roll remains an area of focus. This is where, as opposed to a “reset” roll, the economics – management fees, carried interest and progress through the distribution waterfall – remain substantially the same for the rolling LPs in the new CV. Although a “true” status quo does not really exist, given that the hold period for the assets will likely be pushed out at a minimum, this roll option helps manage certain conflicts of interest inherent in these transactions. The key for GPs is to ensure that the LPs in the selling fund are not prejudiced by facing a dilemma of selling at a price they do not like or rolling on materially worse terms.

The tax analysis for a status quo roll option is complex, particularly when dealing with a global investor base and investments located in different locations. A tax neutral roll, particularly for the fund management team, can be difficult depending on the laws of the relevant jurisdictions.

CONTINUATION VEHICLES WITH CREDIT FUNDS

Although still a relatively nascent market, private equity secondaries technology is increasingly being adapted for a wider scope of asset classes, including credit funds (despite the fact that credit assets, being self-liquidating, are inherently different from private equity assets). On the buy side, buyers are usually buying into credit assets at a discount to par. The internal rate of return (IRR) can be attractive because the secondary investor can return capital quickly and mitigate the J-curve. In a GP-led liquidity solution for credit assets, a strip of loans can be moved into a CV, which can itself take on leverage to create a levered credit strategy. Often, the GP can simply move these loans without significant transfer restrictions that might otherwise apply in the case of equity assets.

CV PERCEPTION

There has been negative press around the use of CVs by managers / GPs of private funds. However, investor sentiment – a key consideration for fund managers, particularly in a tighter fundraising environment – may be more nuanced in practice. Some commentators question the use of CVs, particularly as the GP is ostensibly acting on both sides of the transaction, being manager of both the selling and the continuing fund, giving rise to conflicts of interest issues. While, in the past, CV transactions were associated with more difficult assets, CVs today are mostly investing into “trophy” assets; secondary investors are focused on quality, and these transactions are a means by which GPs can hold onto their flagship assets for longer in order to maximise value. The market has also adopted a set of best practices in a way that helps mitigate the conflicts of interest issues. A GP can manage the CV transaction as a true third-party auction process by using a third-party intermediary, and some GPs may even opt to sell a minority strip to a third-party to facilitate price discovery. For many transactions, there will also be a fairness opinion issued by a third-party firm. In addition, fund managers now pay more attention to the importance of providing investors with a reasonable transaction timeline for assessing the proposed transaction.

CONCLUSION

The GP-led secondaries space is widely considered to be an under-capitalised market. We expect to see increased levels of capital coming into these types of transactions (including from funds with a retail investor base), and more competition on the buy side. Going forward, investors will likely also pay more attention to conflicts of interest issues and increase pressure on GPs in their assessment of transactions, including whether a "true" status quo roll mechanism is on the table.

If you would like to discuss CVs or explore other liquidity solutions, please feel free to reach out. Our team would be delighted to share our insights and assist you in navigating different liquidity solutions with confidence.

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