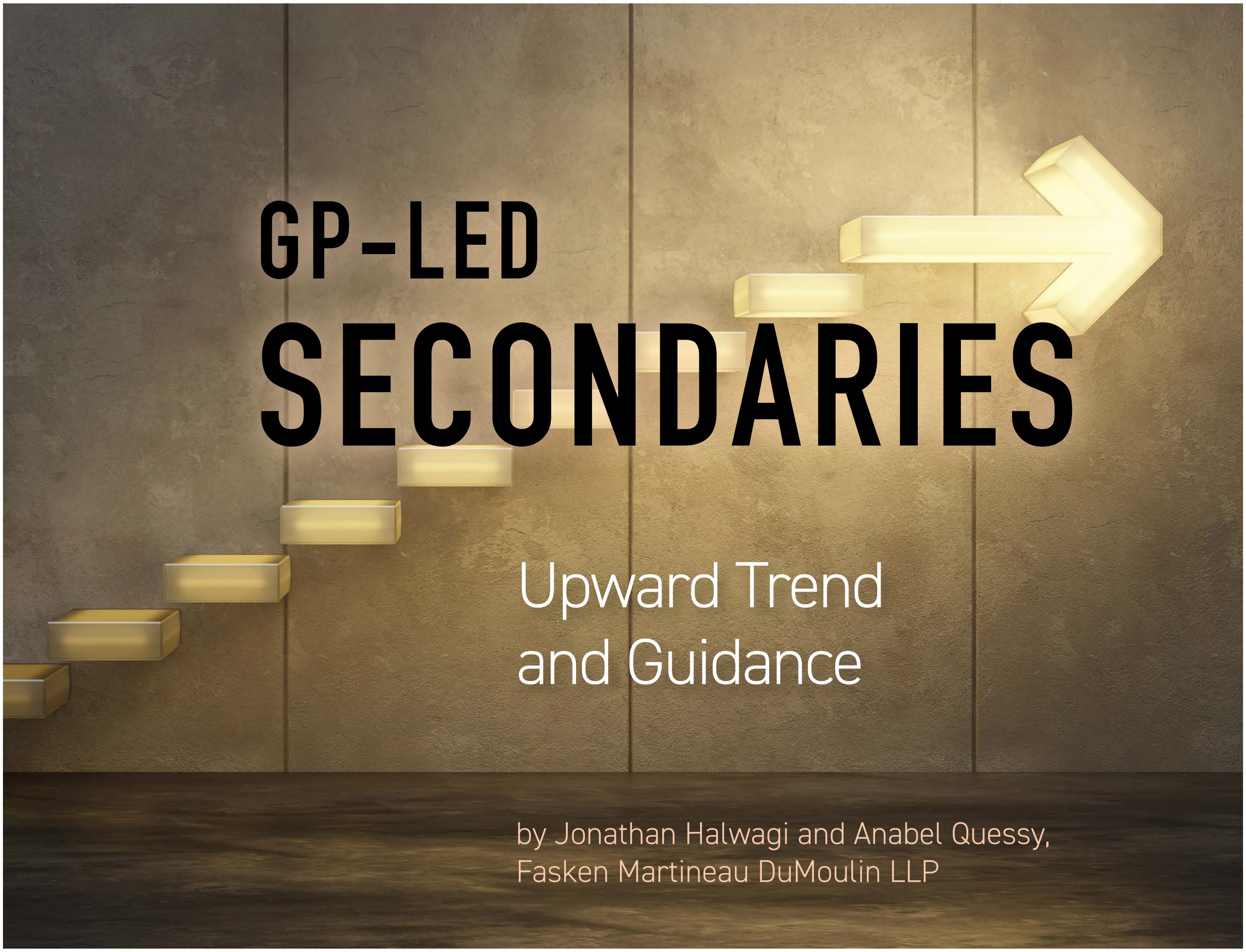

GP-LED SECONDARIES

Upward Trend and Guidance

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After a record high of $22 billion in secondary deals lead by financial sponsors in 2018, 2019 is anticipated to be another record year for the secondary market. Secondaries have been on the rise for several years now.[1] The general partner (GP)-led processes to restructure fund portfolios are not only becoming more commonly accepted and continuing to attract attention by stakeholders in the private equity industry,[2] they are also growing in scope and in scale.[3]

Secondary investors seek to invest in managers that will use their investment for endeavors accretive to the value of the management company. Consequently, GP-led secondary transactions primarily stem out of GPs requiring additional commitments to launch new initiatives in new sectors and geographies, to increase a fund's commitments and to seed new strategies.[4]

The most common transaction structures for GP-led secondary transactions fall into the following categories:

- ***Secondaries Directs****, where the GP sells any remaining portfolio assets to a secondary investor;*
- ***GP-Led Tender Offers****, where the GP tenders all or a portion of the existing limited partners (LPs) interests to a secondary investor;*
- ***GP-Led Restructurings or Fund Recapitalisations****, where the GP establishes a new vehicle, that it will manage and in which a secondary investor will invest, and transfers all or a portion of the portfolio assets of the existing fund to such new vehicle, with existing LPs having the option to redeem out of the existing fund or to roll over their interests in the new vehicle;*
- ***Stapled Secondaries****, where the GP structures a hybrid transaction composed of a primary offering in the existing fund and either a restructuring or a tender offer, and offers the existing LPs to either (i) increase their commitment in the existing fund (with*

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a secondary investor investing additional commitments, to allow the GP to make follow-on investments), or (ii) roll their interests.

GPS SHOULD ARTICULATE A CLEAR AND CONCISE RATIONALE AND ADDRESS ANY CONFLICT OF INTEREST EARLY IN THE TRANSACTION PROCESS

GP-led secondaries have proven to be an excellent way to provide liquidity for LPs and to maximize the value of fund's assets by extending the term of the fund.[5] Nevertheless, GPs should carefully consider potential issues that may arise in order to avoid unsuccessful transactions. Notably, GPs should be mindful of any existing stakeholder rights, any tax consequences of the proposed transaction and of potential conflicts of interests that may arise.

GP-led secondaries are especially ripe with conflicts of interest that will need to be managed by GPs, in most cases, in concert with the LPs and secondary investors. As the GPs are generally involved on both sides of the transaction, their interests may come into conflict, or may be perceived to come into conflict, with that of the LPs. In the case of Secondaries Directs, a GP's interest as the recipient of carried-interest may come into conflict with the interest of LPs. In the case of GP-Led Tender Offers, GP-Led Restructurings or Stapled Secondaries, the fact that the GP will continue to be involved in the management of the assets adds an additional layer of conflict to be considered by the GP and its LPs. In addition, conflicts of interests may exist between groups of LPs where one group wishes to rollover to the new vehicle and the other wishes to redeem out.

In order to foster successful transactions, GPs should articulate a clear and compelling transaction rationale and address any conflict of interest early in the transaction process. In addition, GPs should show transparency, encourage communication, provide sufficient time for the parties to consider the issues, and, to the extent required, seek third party-input.

In light of the growing popularity of GP-led secondaries, the Institutional Limited Partners Association published *Considerations for Limited and General Partners* in April 2019, a guide that GPs can consider when contemplating these transactions. This guide can be a useful checklist of items GPs should consider and discuss when planning a GP-led secondary. Focused on encouraging successful, transparent and efficient GP-led secondaries, the guide notably provides that:[6]

1 GPs must engage and inform the LPs and the Limited Partner's Advisory Committee (LPAC) as soon as possible in the process and seek to provide them with as much information as possible.

GPs should endeavor to achieve parity in the information provided to the secondary investor, to the LPAC and to existing LPs. ILPA points out that GPs should provide:

- *sufficient information for the LPs and LPAC to be able to assess whether the GP-led process was appropriate to secure a fair price (disclose: number, range and content of bids received);*
- *a detailed overview of how the economics between the GP and the secondary investor will be structured;*
- *a summary of any impact of the transaction for the LPs (disclose: management fees and carried interest amount for LPs in the continuing fund or in the existing fund and any significant changes in the terms of the fund),*
- *adequate disclosure on potential conflict of interests (disclose: detailed information relating to the conflict and whether any LPAC member is participating in the transaction as an acquirer).*

2 GPs should establish a fair process that provides all stakeholders adequate time and resources to make an informed decision.

In the establishment of the process, the GP should, on the one hand, seek to comply with the limited partnership agreement. Terms such as conflict of interest approval protocols, voting processes and valuation procedures, notice periods, expense allocation, including broken deals, and required disclosures should be taken into consideration. On the other hand, GPs should also consider involving any other stakeholders early on in the process. GPs should consider whether LPs have institutional requirements, such as ERISA, whether there are any other stakeholders such as management teams, co-investors and lenders.

In establishing the timeline, ILPA recommends that LPs be given no less than 30 days (or 20 business days) to consider the proposal before making a decision.

3 Parties should consider whether third party advisers should be appointed.

ILPA recommends that:

- *GPs appoint and experienced advisers to solicit bids;*
- *The LPAC review the GPs selection of the adviser and have access to the adviser throughout the solicitation process;*
- *The LPAC consider engaging an independent legal and specialist adviser;*
- *In certain circumstances, the LPs obtain an independent assessment of the value of the portfolio, together with a fairness opinion.*

Endnotes

1 Lazard Frères & Co. LLC, "Financial Sponsor Secondary Market 2018 Year-End Review" (2019) at p. 1, online (pdf): Lazard <www.lazard.com/media/450841/financial-sponsor-secondary-market-2018-year-end-review_vdistribution.pdf>.

2 Institutional Limited Partners Association (ILPA), "GP-led Secondary Fund Restructurings - Considerations for Limited and General Partners" (2019) at p. 3, online (pdf): ILPA <ilpa.org/wp-content/uploads/2019/04/ILPA-Guidance-on-GP-Led-Secondary-Fund-Restructurings-Apr-2019-FINAL.pdf>.

3 Lazard, supra note i at p. 3.

4 James Gelfer, Jordan Beck & Darren Klees, "How GP Stakes Investing Is Becoming Less Rare - A review of the uptick in GP stakes investing" (2018) at p. 2-3, online (pdf): PitchBook <files.pitchbook.com/website/files/pdf/PitchBook_3Q_2018_Analyst_Note_How_GP_Stakes_Investing_Is_Becoming_Less_Rare.pdf>.

5 ILPA, supra note ii at p. 3.

6 We have not sought to summarize all recommendations set out in the ILPA publication, supra note ii.