

Talking. Secondaries.

Demystifying the secondaries market
Part 3: Continuation fund



A vehicle capitalised by a secondary buyer and managed by the existing GP acquires one or more assets from the existing fund.

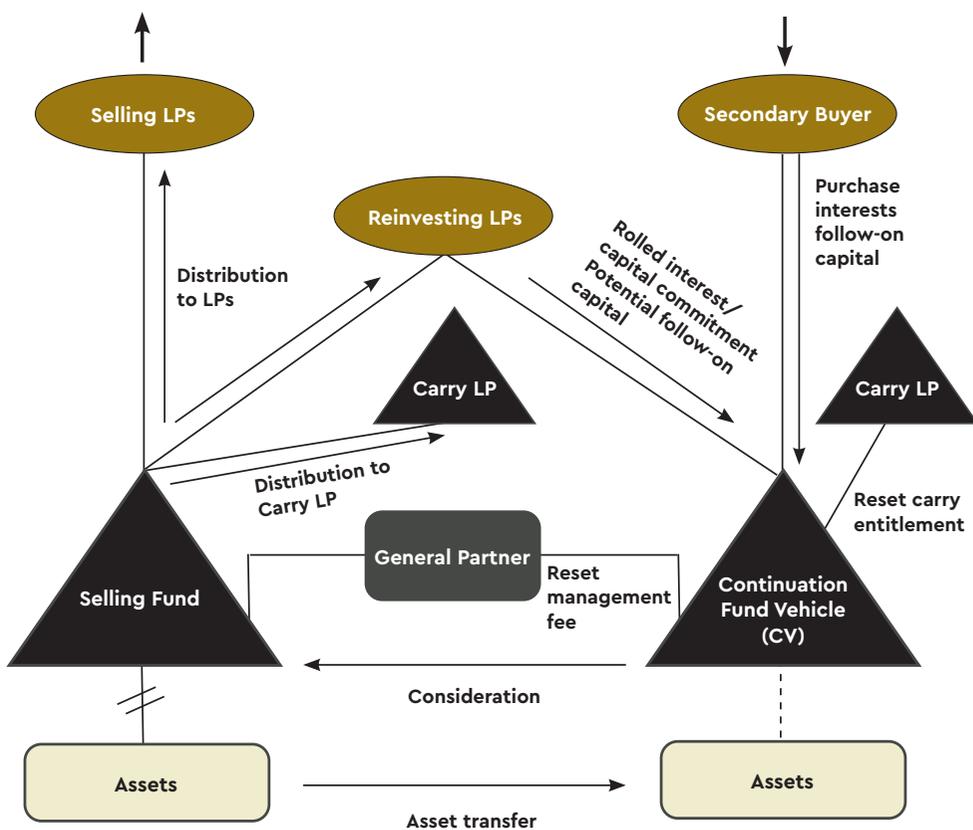
Summary

Why use a Continuation Vehicle?

- Maintain exposure to high-performing assets or maximise returns on under-performing assets.
- Extend the hold period for assets while raising significant further follow-on capital to enhance returns.

What is the process?

- Principal secondary buyer becomes lead investor in continuation vehicle.
- Existing LP base offered the option to sell or to 'roll' into the continuation fund.
- New carry arrangements may be established to align interests of secondary buyer, GP and electing LP.



Key considerations

Conflicts of interest

- Managing actual/potential conflicts of interest is fundamental – this includes articulating the commercial rationale, implementing appropriate structuring, generating arm's length/fair pricing, ensuring transparency via disclosure/communication in selling fund and underpinning future alignment with robust CV economics.
- LP engagement will be needed, the LPAC may need to approve any conflict.

Key documentation

- Buyer LPA.
- Election Memorandum.
- Framework Agreement.
- Equity Commitment Letter (if not included in the Framework Agreement).
- SPA(s).

Election process

- Election to sell or "roll" may also include an option to increase a rolling LP's commitment in the CV.
- Election process timeline varies but ILPA suggests 20 BDs. That said, further ILPA guidance on CV processes is expected imminently and so this recommended timeframe may change in coming months.
- Lead investors may require minimum/maximum participation. Thus, LP participation may be subject to deductions, adjustments, scale ups and/or scale backs.

Conditionality

- Closing conditions may include: LPAC consent, LP election participation, or other third-party consents (e.g., FDI, merger control/anti-trust, national security, financing, underlying portfolio management etc.).

Liability

- Warranties will be given by the selling fund, its GP and the CV. Depending on the deal dynamic, warranties may be given by management of the underlying portfolio.
- Warranty scope varies depending on the underlying portfolio. Historically, CV deals were warranty-lite but the scope of warranties typically extends as the transaction becomes more concentrated (i.e., single asset CVs are more akin to traditional M&A).
- W&I insurance is a standard tool to manage transaction liability.

CV economics

- Key to generating day 1/future alignment.
- Management fees typically lower than on main vintages of fund depending on target asset(s) (ILPA recommends proportionality).
- Carried interest may be layered/ratcheted to drive high returns.
- A high proportion of (and sometimes all) sell-side crystallised carried interest is typically reinvested.
- GP commit/co-invests from flagship vintages are commonly used to improve skin in the game/demonstrate conviction in the business plan.