EAVCA

East Africa Venture Capital Association

White Paper | GP-Led Secondaries

Continuation Funds

Delivering Liquidity to Limited Partners in a Tough Exit Environment while Retaining Interests in 'trophy assets'

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PREAMBLE

GP-Led Secondaries-Private Equity's 'Fourth Exit' Route[1]

The fast-changing private equity industry landscape is increasingly necessitating that GPs navigate the confluence of macro challenges affecting their business by innovating and devising new strategies and tactics to deal with emerging challenges. One of such emerging challenges presents as an increasingly tough and deteriorating exit environment, making it difficult, in the first place- to find asset buyers and, in the second place, where asset buyers are sourced, to exit assets at fair pricing[2].

For GPs, the pressure to exit assets is exceptionally high when the Fund holding the assets is at the tail end of its ten to fifteen-year fixed-term life. At the tail end of the Fund's life, a GP has to decide how to swiftly exit assets on the Portfolio to deliver returns to investors (LPs) and formally wind down the Fund. In a challenging exit environment, delivering said exits to coincide with the expiry of a Fund's term can be particularly challenging for a GP. This is more so when the GP is convinced that one or more assets still held on its Portfolio are not only delivering strong returns presently but still have great potential for further value creation further down the line (future upside). The GP may be convinced that such assets, while strong performers now, are yet to reach their optimal value creation potential and are "not yet ripe for an exit. In this instance- and faced with an exit market offering low asset pricing- the GP may want to continue holding the assets longer, beyond the life of the current Fund, pulling on an assortment of strategic and operational value creation levers towards greater value creation in hopes of achieving greater returns on the asset in future[3].

A possible solution to this unique problem? Continuation Funds. A type of GP-led secondaries transaction and an emerging innovation – now dubbed private equity's "fourth exit route" after trade sales, IPOs and secondary buyouts – a Continuation Fund provides a GP facing the exit or hold dilemma at the tail end of a Fund's life, with two options. Namely, the option to exit high-performing assets with future upside, AND after the exit, also maintain exposure to the same exited assets. The mechanism is facilitated through the set-up, by a GP, of a Continuation Fund – a separate and distinct legal entity and Special Purpose Vehicle, but also an Annexe of the Existing [Legacy] Fund at the tail end of its life – to facilitate the sale and transfer of interests held by the Legacy Fund in one or more portfolio companies, to the newly formed Special Purpose vehicle. The sale and subsequent transfer of assets from the Legacy Fund to the Continuation Fund implies a write-off of the assets from the books of the Legacy Fund, enabling the GP to deliver an exit on the assets and to make distributions to LPs after that. Further, as the GP of the newly formed Special Purpose Vehicle to which Legacy Fund assets have been exited through a sale, the same GP simultaneously benefits from continued exposure to the assets in question. The Continuation Fund thus facilitates a simultaneous "exit" and "hold" scenario on an asset for a GP, making two previously zero-sum outcomes complementary[4].

It must, however, be noted that the transaction that facilitates the set-up and operationalisation of the Continuation Fund –the GP-led secondaries transaction – is inherently a related-party transaction. GP-led secondaries transactions will thus often be utilised as an exit tool of last resort only when all other exit options have been thoroughly explored and dismissed – with conflicts of interest flagged and carefully managed during the transaction process. Regardless, GP-led secondaries are gaining increasing acceptance by GPs and LPs and are becoming a more commonly used strategy in the exit toolbox available to GPs, with the first notable momentum seen in the 2021 to 2023 period.

This white paper – a product of in-depth desk research – is merely informational and provides an overview of the concept of GP-led secondaries transactions towards the set-up and operationalisation of a Continuation Fund, the Structure of the Fund, the process for executing a GP-led secondaries transaction and possible risks and mitigative measures to consider when executing the transaction.

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[1] Dayal, M. (2023). Private Equity's 'Fourth Exit' Crimped by SEC Plan, Lawyers Say. Bloomberg.
[2] Kupec, B., Lightbown, S., Remmerbach, A., & Feder, J. (2022). Private equity exits: why investors should look beyond the headlines. Moonfare.
[3] Porsche Consulting. (2022). Private Equity Value Creation - How to face the challenges of the current private equity environment.
[4] Bowen, K. A., & Harline, M. S. (2023). Subscription Credit Facilities: Continuation Funds. Mayer Brown.

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Abbreviations & Acronyms

DPI	Distributed to Paid-In Capital
EURIBOR	Euro Interbank Offered Rate
GP	General Partner
ILPA	International Limited Partners Association
IPO	Initial Public Offer
IRR	Internal Rate of Return
LLP	Limited Liability Partnership
LP(s)	Limited Partners
NAV	Net Asset Value
PPM	Private Placement Memorandum
SEC	Securities and Exchange Control
SPV	Special Purpose Vehicle
TVPI	Total Value to Paid-In Capital

PART 1: Context | Continuation Funds

Defining Characteristics and Motivations

The end of fund life debacle – a GP's vehicle to continue the journey with 'trophy assets'

While portfolio company exits can be delivered by a Private Equity Fund – at any moment- as realised during the fixed term life of a private equity fund, two to three years approaching the end of the life of the Fund, the General Partner (GP) of a Fund may be faced with a unique challenge- namely how to swiftly exit assets still held on the Portfolio to deliver returns to investors and to enable a formal wind down of the Fund vehicle. This is because exits must be fully realised at the end of the Fund's life for two reasons: first, such that investors into the Fund – particularly Limited Partners (LPs) – can realise a return on investment in liquid terms fully, and second, such that the end of the fixed end term of a closed-ended Fund coincides with the total return to investors of capital that was committed to the Fund, i.e., where the Distributed to Paid-In Capital (DPI) is equal to Total Value to Paid-in Capital (TVPI) - as a measure of the track record and performance of the now concluding Legacy Fund.

Amid a challenging exit environment- characterised by low asset valuations and few potential asset buyers-, delivering exits on assets held on Portfolio to coincide with the expiry of the term of a fixed-term closed-ended Legacy Fund can be particularly challenging for a GP of a Fund now nearing the end of fixed term its life. This can be tough, more so when a GP is convinced one or more assets still held in its Portfolio are not only delivering strong returns presently, but still have further value creation and growth potential further down the line (future upside) – hereafter referred to as **'trophy assets'**. The GP may be firmly convinced that such assets, while strong performers now, are yet to reach their optimal value creation potential, may benefit from an extended hold period to better yield optimal returns and are thus not yet ripe for an exit. In this instance- and faced with an exit market offering low asset pricing- the GP may want to continue a hold on the assets beyond the life of the current Fund, with the intent of pulling on an assortment of strategic and operational value creation levers during the extended hold period towards greater value creation. This is in hopes of achieving greater returns on the asset in future[5].

In this instance, and nearing the end of life on a Legacy Fund still holding on Portfolio one or more 'trophy assets'– but with potential for future upside –the GP faces two mutually exclusive pathways that would typically not co-occur. Namely, – **1)** the option to exit the asset now to coincide with the end of the fund term- and possibly acquiesce to valuations lower than the trophy asset's future worth, – hence foregoing returns from future upside; or **2)** the option otherwise, to hold onto, and manage the 'trophy assets', likely through a two-year extension on the Legacy Fund holding the assets on the portfolio, towards reaping future upside. The latter option would, however, delay an exit on the asset and delay timelines for distributions due to the LPs of the Legacy Fund in question and impact track record metrics (DPI=TVPI) needed for raising a successor fund.

A Continuation Fund- and the GP-led secondaries transaction that operationalises the Continuation Fund - makes possible the two mutually exclusive pathways – namely, an exit on a trophy asset by a GP of a Fund nearing the end of its life and pro rata distributions to the LPs of the Fund, and after the exit, subsequent continued exposure to the same asset by the same GP in another vehicle to reap future upside. The mutually exclusive pathways are effected through an exit and hold mechanism – as facilitated by the GP-led secondaries transaction described in this white paper.

[5] Porsche Consulting. (2022). Private Equity Value Creation - How to face the challenges of the current private equity environment.

Continuation Funds – an 'exit' & 'hold' strategy on 'trophy assets' held in a winding down Fund

I. A continuation fund and the GP-led secondaries transaction

A type of GP-led secondaries transaction, a **Continuation Fund,** is a Special Purpose Vehicle (SPV) set up by a GP of an existing fixed-term life private equity fund (hereafter referred to as a "**Legacy Fund**") as an Annexe to the Legacy Fund, but also as a separate and distinct legal entity from the Legacy Fund. The existence of the two Funds —namely a Legacy Fund and its Annexe, a Continuation Fund —as separate and distinct legal entities implies the Legacy Fund and the newly set up Continuation Fund can transact with each other in a related-party transaction, regardless of their management by the same GP. The setup of the Continuation Fund as an SPV is thus to facilitate the sale (**exit**)— by a soon-to-wind-down Legacy Fund — of interests held in one or more portfolio companies (hereafter referred to as "**assets**") to the newly formed Continuation Fund — managed by the same GP— and on asset transfer, to subsequently facilitate continued exposure on the assets by the same GP beyond the life of a Legacy Fund through the Continuation Fund that has purchased the assets (**hold**). The Continuation Fund thus facilitates a simultaneous **'exit' and 'hold'** scenario on an asset for a GP, making two previously zero-sum and mutually exclusive outcomes complementary[6].

The Continuation Fund will typically have a 5 to 6-year term, plus optionality for extensions, hence providing a GP optionality for extending the hold runway and value creation period for an asset at the centre of a GP-led transaction for a Continuation Fund to 5 to 6 years[7].

II. The 'trophy asset' at the centre of a continuation fund

Historically, a transfer of assets from an existing Legacy Fund at the end of its life, to an Annexe Fund owned by the same GP, so as to facilitate a simultaneous quick exit on assets held by the winding down Fund, and after exit, continued ownership of the same assets by the same GP, has always been that of distressed assets. Such Annexe Funds, known as "**Zombie Funds**",- have been widely used as a strategy by Funds in the wind-down phase to dispose assets from a Fund that are "past their holding period" but that possess no viable means for exit as they are both cash-flow and balance sheet insolvent, but that need to be swiftly exited to facilitate entire disposals of assets from a Legacy Fund, capital distributions to the LPs of the Legacy Fund, and thereafter a formal Fund wind-down process[8,9].

In contrast, assets (portfolio companies) held in a soon-to-wind-down Legacy Fund and, sold and transferred to a Continuation Fund- also an Annexe Fund run by the same GP- will be high performing assets. These will be assets with potential for future upside- beyond the fixed term life of the soon-to-wind-down Legacy Fund in which they are held. For the GP, the objective of exiting trophy assets from a Legacy Fund at the tail end of its life through an asset sale to a newly formed Continuation Fund, managed by the same GP, will be to maintain continued exposure to the assets beyond the fixed term life of an existing Fund, so as to reap future upside through an extended hold period; but also to exit the assets from the Legacy Fund so as to distribute returns to its LP-base, on all capital committed, before liquidation of the Legacy Fund. On obtaining an extended hold period through a Continuation Fund, the GP will then proceed to inject **Follow-On capital** into the trophy asset now held in a

[6] Bowen, K. A., & Harline, M. S. (2023). Subscription Credit Facilities: Continuation Funds. Mayer Brown.
[7] Paul Hastings. (2022). Continuation Vehicles: Six month snapshot of the key terms of continuation vehicles. Paul Hastings
[8] Álvarez, L., García-Posada, M., & Mayordomo, S. (2023). Distressed firms, zombie firms and zombie lending: A taxonomy. Journal of Banking and Finance.
[9] Woodman, A. (2023). Zombie funds could rise again, but there are antidotes. Pitchbook. Retrieved from Pitchbook.

Continuation Fund, over the 5 to 6-year term of the newly formed Fund, so as to finance strategic and operational improvements for returns to be realised at a future time.

The Continuation Fund will thus enable the GP to "continue and finish what it had started" – as relates to their value creation strategy on high-performing portfolio companies –without constrain from the impending expiry of the fixed term duration of a closed-ended Legacy Fund.

III. Operationalisation dynamics of a continuation fund

The Continuation Fund – operationalised through a GP-led secondaries transaction – has a multiplicity of players and operationalisation dynamics as follows [10, 11, 12, 13, 14].

1. **"New LPs"** New LPs Committing Capital to a newly formed Continuation Fund.	The operationalisation of a Continuation Fund is premised on the sale and transfer of trophy assets held in a soon-to-wind-down Legacy Fund, to a newly formed Annexe Fund- being the Continuation Fund. The purchase and subsequent ownership transfer facilitates an extended hold period on an asset by the same GP- and for a subsequent injection of follow-on capital on the transferred asset over the life of a Continuation Fund to reap from future upside. Such a purchase of assets by the new vehicle from a winding down fund vehicle -as the GP-led secondaries transaction - requires cash to take effect, hence the need for capitalisation of the newly formed Continuation Fund. To initially capitalise the newly formed Continuation Fund, such as to facilitate the GP led secondaries transaction, the Sponsor (GP) of the Continuation Fund – who is also the GP of the soon-to-wind-down Legacy Fund– fundraises fresh capital from New Limited Partners (LPs) - known as "**New LPs**". Initial capital commitments from New LPs give the Continuation Fund adequate initial liquidity to facilitate the purchase and subsequent transfer of one or more trophy assets from the Legacy Fund.
2. "Legacy Fund LPs" The LP base of the Legacy Fund from which assets are being transferred to a Continuation Fund	A Continuation Fund's purchase of assets from a Legacy Fund- effected through cash obtained from capital commitments into the Continuation Fund by "New LPs", and subsequent transfer of assets previously held in a Legacy Fund to the Continuation Fund- implies a write-off and, hence, exit of the assets from the Legacy Fund. With proceeds earned from the exit, the Legacy Fund can then proceed to distribute pro rata returns to its LP base. Given that the Continuation Fund is also an Annexe to the Legacy Fund from which assets are purchased, following the "exit" delivered through the GP-led secondaries transaction, and upon entitlement to pro-rata distributions, Legacy Fund LPs are entitled to exercise either one of three rights as follows: – As a first option, 'Legacy Fund LPs' – could opt to re-invest/roll over as capitalisation into the newly formed Continuation Fund, the equivalent of their pro rata distributions earned from the exit of an asset through the GP-led secondaries transaction, and likely top this up with additional capital commitments. These are referred to as "**Rolling LPs**". On "rolling" their interests, these join the New LPs as part of the Continuation Fund's LP base. – As a second option, 'Legacy Fund LPs' could cash out on their pro rata distributions earned from the exit of an asset to the Continuation Fund through the GP-led secondaries transaction and, by doing so, obtain liquidity and exit from the Legacy Fund with no continued engagement in the newly formed Continuation Fund. These are known as "**Selling LPs**".

[10] Stauder, S. P., Berman, G., & Clarkin, M. (2021). Co-investments: continuation funds and other considerations. TORYS.
[11] Dylke, E., McCullough, J., & Bacic, M. (2022). Continuation Funds: A Growing Trend. Benner Johns
[12] Reeve, D., & McNaney, M. (2022). The rise of continuation funds. AZTEC Group.
[13] Woodman, A. (2021). Continuation funds: How GPs are holding on for longer. Pitchbook.
[14] Schwartz, K. (2023). In It for the Long Haul: Continuation Funds on the Rise. Middle Market Growth.

	– As a third option, 'Legacy Fund LPs' could be partially "Rolling LPs" and "Selling LPs"- simultaneously exercising options One and Two. On "rolling" partial pro-rata distributions from the GP-led secondaries transaction, these join the New LPs and Fully Rolling LPs as part of the Continuation Fund's LP-base.
3. GP (Sponsor) The GP of the Legacy Fund disposing trophy assets, who is also the same GP of the Continuation Fund purchasing assets from the Legacy Fund.	Pro-rata distributions of returns to the LP-base of the Legacy Fund following the exit on assets by the Legacy Fund to a Continuation Fund over and above the hurdle rate implies the GP of the Legacy Fund- who also happens to be the GP of the Continuation Fund- is entitled to carried interest earnings. To further capitalise the newly formed Continuation Fund – above and beyond capitalisations from New LPs and "Rolling LPs" – the Sponsor (GP) of the newly formed Continuation Fund, – who is also the GP of the Legacy Fund – is expected to have "skin in the game" in the newly formed Continuation Fund. The GP will thus roll over into the newly formed Continuation Fund, all or part of the carried interest earned by the GP ("crystallised carried interest") as a result of the exit(s) delivered – following the sale of assets by the Legacy Fund to the new vehicle, and further following subsequent distribution of returns to Legacy Fund LPs by the GP. **IMPORTANT CAVEAT:** It is important to note that the carried interest distribution waterfall mechanism prescribed in the Fund Agreement of a Legacy Fund may complicate the process of crystallising carried interest and subsequent rollover to the Continuation Fund, particularly where, after the GP-led transaction, the Legacy Fund still holds assets on its portfolio. Where the Fund Agreement of a Legacy Fund prescribes a "**Deal-by-Deal**" approach to earning carried interest, upon delivering an exit on an asset through a GP-led secondaries transaction and thereafter making pro-rata distributions to LPs, the GP can earn carried interest attributable to the exited asset immediately, enabling the GP to roll over crystallised carried interest to the newly formed Continuation Fund as capitalisation (subject to Clawback provisions on liquidation of the Legacy Fund). On the other hand, where the Fund Agreement of a Legacy Fund prescribes an "**All Capital First** " approach, where a Legacy Fund- after a GP-led secondaries transaction- still holds assets on portfolio, the GP would have to deliver exits on the remaining assets held in the Legacy Fund before any carried interest is earned, thus complicating the process of earning and rolling over crystallised carried interest to the newly formed Continuation Fund as capitalisation from the sale of one or more assets through the secondaries transaction.
4. Trophy assets Interests in Portfolio Company(ies) sold (and exited) by the Legacy Fund to the Continuation Fund.	The Continuation Fund is capitalised by a combination of capital fundraised from New LPs, Pro rata interests transferred, and additional capital rolled over into the newly formed fund by Legacy Fund LPs, and the GP's crystallised carried interest from the Legacy Fund attributed to the sale of assets transferred to a Continuation Fund. Net of the capital initially used by the Continuation Fund to purchase trophy assets underlying the GP-led secondaries transaction from the Legacy Fund, the capitalisation of the Continuation Fund enables the Fund to invest follow-on capital into the portfolio companies transferred from the Legacy Fund to the Continuation Fund in the hopes of unlocking optimal value creation potential for future returns.

It must be noted that a Continuation Fund and the transaction that facilitates its set up and operationalisation –the GP-led secondaries transaction – is inherently a related-party transaction. In essence, the GP is achieving an 'exit' and 'hold' by selling an asset to itself– through the Legacy Fund and buying the same asset from itself –through the Continuation Fund–, albeit through different separate and distinct legal entities- granting the GP continuity in managing the asset for future upside. GP-led secondaries transactions will thus often be utilised as an exit tool of last resort, used only when all other exit options have been thoroughly explored and dismissed – with conflicts of interest flagged, disclosed, and carefully managed during the transaction process (see **Part 4: Considerations**).

Further, a Continuation Fund is a "high stakes" game for the GP. It represents a substantive material risk to the GP, particularly as the GP is expected to roll over all, if not most- crystallised carried interest earned from the Legacy Fund as accruing from the sale and transfer of the assets from the Legacy Fund to the Continuation Fund. If the intent of setting up the Continuation Fund is to hold onto one or more high-performing assets longer- to reap from the future upside of said assets- a reasonable degree of certainty on the quality of assets is required. A GP should be fairly certain – as reasonably possible– that the assets underlying the GP-led secondaries transaction are worth the time, expense and risk required to set up and operationalise the SPV for their benefit.

Exits now, returns tomorrow – The dual objective of Continuation Funds

The Continuation Fund- as operationalised through a GP-led secondaries transaction- exits to serve **two purposes**. Namely,

The **first purpose** is to deliver exits on an existing Legacy Fund at the tail end of its fixed term 10 to 15-year life, enabling a GP to deliver returns to LPs invested in the Fund. An exit is achieved through a sale of trophy assets by the Legacy Fund to the Continuation Fund, implying asset disposal and a write-off from the books of the Legacy Fund subsequent to a GP-led secondaries transaction. An exit on assets allows distributions to be made pro rata to Fund investors (GPs and LPs)- with LPs then having the option to cash out their interests from the exit delivered, in exchange for liquidity ("Selling LPs").

The **second purpose** is to allow the GP to maintain exposure to 'trophy assets' beyond the fixed term 10 to 15-year life of an existing Legacy Fund to obtain potential returns from future upside in years to come. A hold is achieved by having the GP of the Continuation Fund holding assets purchased and transferred from a Legacy Fund - who is also the GP of the Legacy Fund from which assets were transferred manage the same assets, but under a different legal entity; but also by allowing LPs of a winding down Legacy Fund to roll-over their interests into the newly formed Continuation Fund to also maintain exposure to the assets so as to reap from future upside ("Rolling LPs").

A Continuation Fund thus offers Legacy Fund GPs and LPs **Optionality**"[15, 16].

The If / then game on trophy asset exits; if not Continuation Funds, then what?

<u>THE SCENARIO</u>: Outside a Continuation Fund, in a scenario where a [Legacy] Fund is at the tail end of its fixed term life- namely in year 7 of a 10-year fund and in year 12 of a 15-year fund- but still holds on portfolio high-performing 'trophy assets', that are "not yet ripe" for exit, - and that would benefit from a more extended holding and value creation period beyond the life of the Legacy Fund, the fund manager is faced with the following asset exit options, each with an '**IF /THEN**' implication:

[15] Bumgardner, S. (2023). Making the Most of Continuation Funds. Cadwalader Wickersham & Taft LLP; Lexology.
[16] Lorenz, L., & Jurva, J. K. (2023). ILPA Releases Continuation Fund Guidance. ArentFox Schiff.

As a Legacy Fund reaches the tail end fixed term life, the GP could opt to:

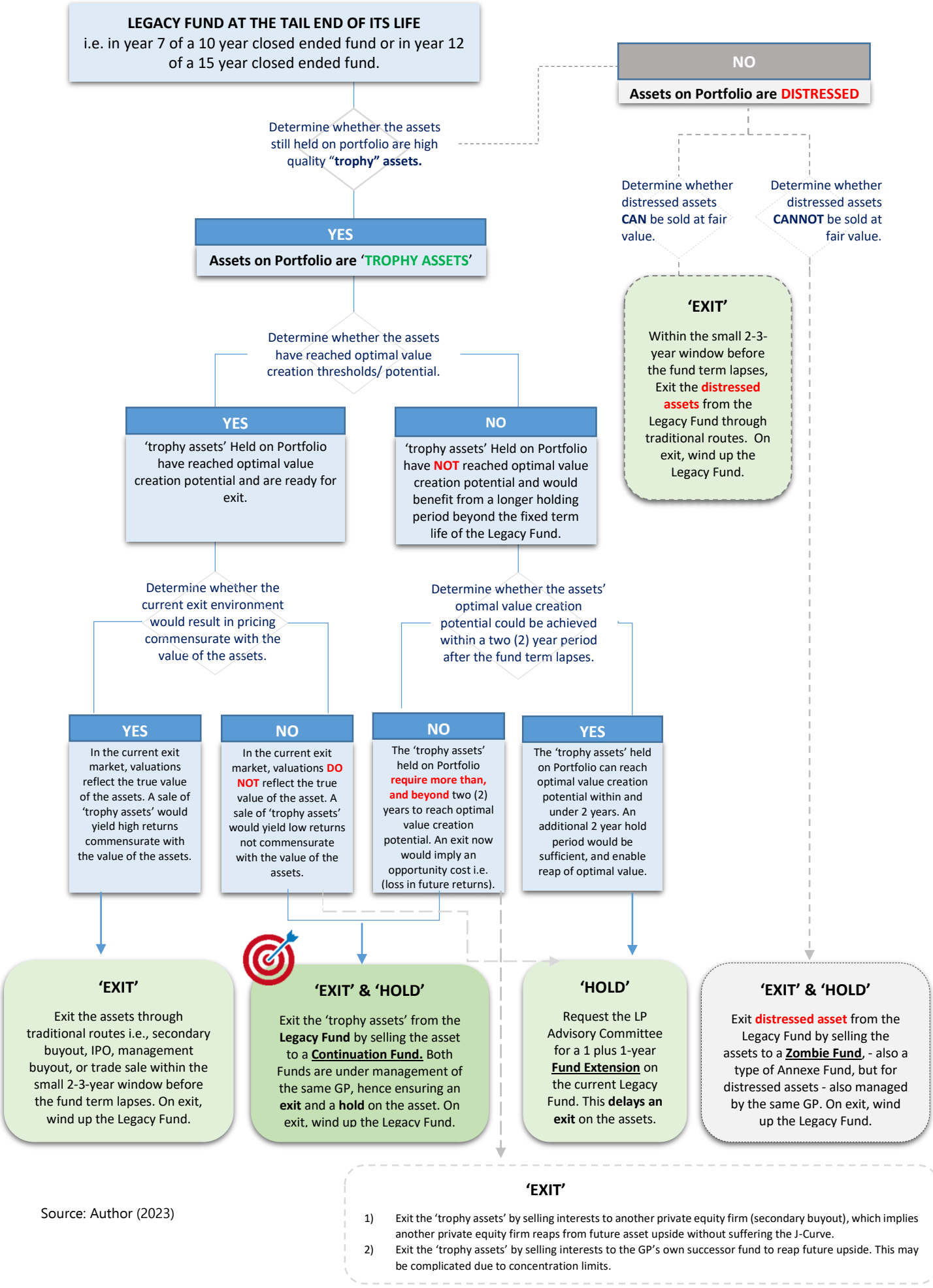
1) **Trophy Asset Exit Option 1: Sell and transfer the 'trophy assets' from the Legacy Fund to a fully-fledged successor fund managed by the same GP**. The private equity model depends on the GP consistently setting up new funds – also known as "**successor funds**" – which often overlap with the life of predecessor funds. In the above scenario- where a GP intends to hold on to assets in hopes of reaping future upside, a GP could sell and transfer the trophy asset to a successor fund managed by the same GP. The successor fund would have a standard term of 10 to 15 years. This transaction would, in essence- provide the GP with an exit of the asset on the Legacy Fund- while simultaneously granting the GP a decade or more to extract value from the trophy asset in question, allowing the GP to exit only when the asset is "ripe for exit". This option is, however, often complicated by concentration limits on successor funds and, hence, may not be the most viable solution to the scenario mentioned earlier. This, as the Fund Agreement of a Legacy Fund commonly prescribes provisions prohibiting the GP from setting up a successor fund with similar target investments to the predecessor fund.

2) **Trophy Asset Exit Option 2: Request the LP Advisory Committee for an Extension on the life of the existing Fund (Legacy Fund)**. Fund extensions typically follow the 1 plus 1 model- implying the possibility of two one-year extensions after the end of the Fund's 10 to 15-year fixed term. Extensions are at the discretion of the GP and are subject to approval from the LP Advisory Committee of the Legacy Fund. In the above scenario, extending the life of a fund would grant the GP one to two years to extract value from the trophy asset in question. This option, while viable, may only be suitable if the GP has determined that it is possible to extract said value in under two years. If value extraction requires two or more years, this may not be the most viable solution to the earlier scenario. In addition, in an environment where LPs in the [Legacy] fund are liquidity constrained due to grappling with the **denominator effect**- and in need of liquidity – delivering exits on the Legacy Fund in a prompt manner would be of emphasis as this would enable these LPs to cash out on their investment interests at the end of the fund life. Hence, a strong justification and rationale – on the part of the GP – may be required to obtain LP approvals on extensions. Further to the above, an extension would delay locking in the track record (DPI) on the Legacy Fund needed to facilitate a successful fundraise for a successor fund by the GP.

1) **Trophy Asset Exit Option 3: Exit the asset through selling interests to another private equity firm –namely, exit by secondary buyout**. This, while viable, would come at a substantive opportunity cost to the GP. In essence, the GP has to decide to sell low now- for immediate exit and liquidity - but miss out on returns from future upside on the trophy asset. In essence, the private equity firm taking over the asset will benefit from the GP's hard work and proprietary find- but without suffering the J-curve as the asset is relatively mature at the time of sale. Further, during a challenging exit environment, the price at which a GP can sell the interests in the asset may be lower than the worth the GP has ascribed to the asset, which would not be ideal. In addition, from the portfolio company's perspective, a change in private equity firms would imply a loss in continuity and a loss in the GP/Portfolio company relationship and value creation strategies that have been key to the company's success to the point of exit.

Faced with the above alternatives at the tail end of the life of a Legacy Fund, particularly during a challenging exit market, a GP may consider pursuing a GP-led secondaries transaction towards setting up a Continuation Fund to enable the GP to extract optimal value from 'trophy assets'. **Figure 1** captures the thought process of making such a decision at a fund's end of life.

Figure 1: The Decision Flow Chat for Exiting Assets held in a Legacy Fund at the Tail End of Its Life



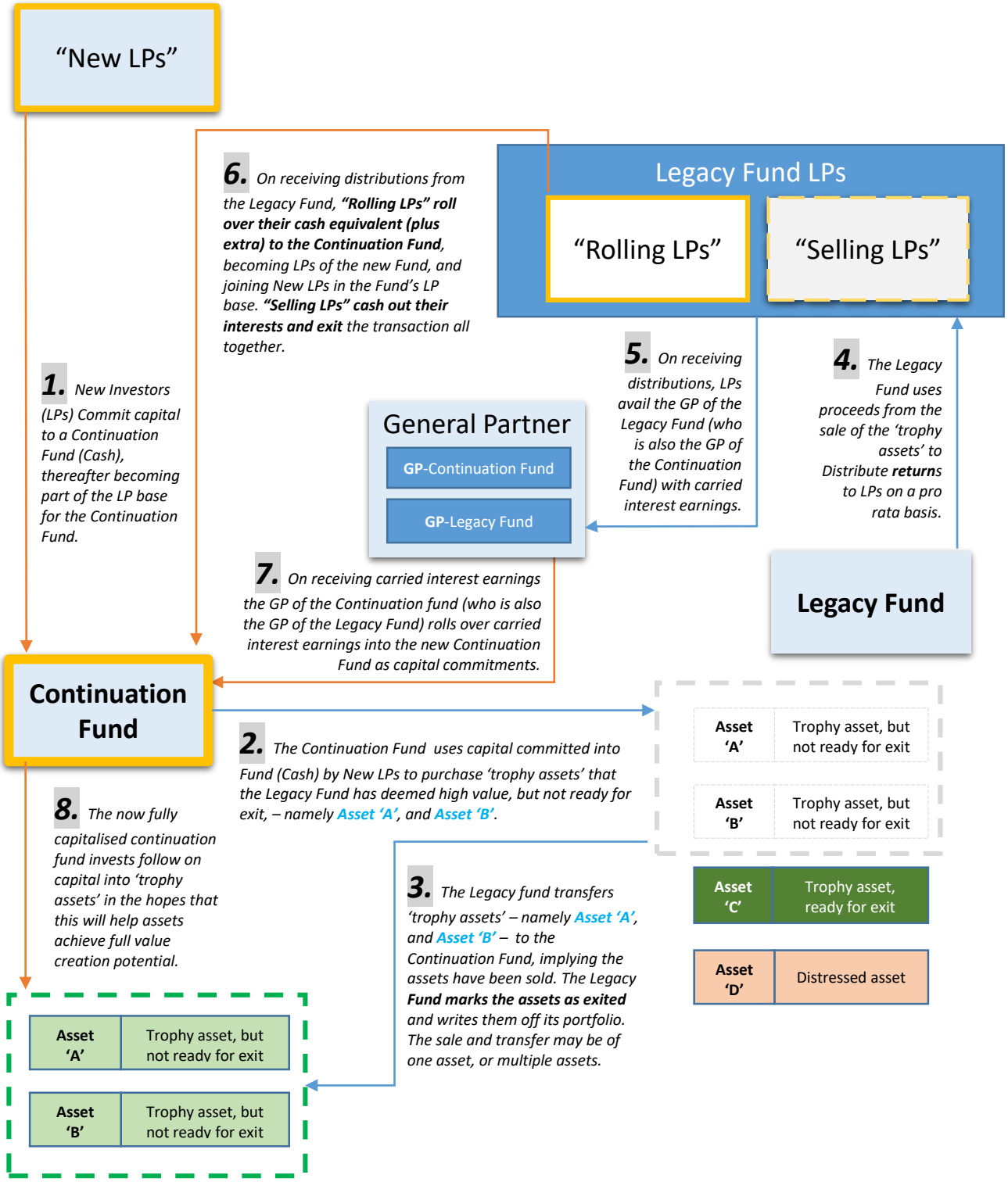
Source: Author (2023)

PART 2: Structuring | Continuation Funds

The Fund Structure of a Continuation Fund

The fund structure of a Continuation Fund and the flow of capital in the Structure is illustrated below.

Figure 2: The Structure and Cash Flows in a Continuation Fund set up through a GP-Led Transaction



Source: Author (2023)

PART 3: The Process | Continuation Funds

Executing a GP-Led Secondaries Transaction

Step-by-step process for executing a GP-led transaction to operationalise a Continuation Fund

Speed and precision in execution and strong technical acumen in navigating related complexities are vital in ensuring successful secondaries transaction close[17,18]. As per the sequential process illustrated in Figure 3 below, **steps 1 to 3** will typically conclude in **1 to 2 months**, with **Steps 4 to 5** concluding in **3 to 4 months.** The entire process will typically conclude within a 6 to 12 month window[19, 20, 21].

Figure 3: Process Flowchart for Execution of a GP-Led Transaction for a Continuation Fund

Source: Author (2023) Adapted from ILPA (2023)[22], and Burdett, Unger & Asplund (2020)[23]

[17] Guryn, D., & Poldauf, P. (2022). The complexity premium in GP-led secondaries. Schroders Capital.
[18] Hamilton Lane. (2021). Secondaries: A Primer. Hamilton Lane.
[19] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[20] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[21] Carroll, A. (2023). How long does it take to complete a GP-led secondaries process? Private Equity International.
[22] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[23] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.

Step 1: GP decision to set up a Continuation Fund as operationalised through a GP-led transaction

A GP considering a GP-led secondaries transaction for continued exposure to 'trophy assets' beyond the life of a winding down Legacy Fund, through a Continuation Fund, will evaluate several feasibility aspects. The feasibility analysis will be carried out after a GP has identified trophy assets held by a Legacy Fund for sale and transfer, and determined that provisions within the Fund Agreement of the Legacy Fund permit such a transaction to occur. An initial feasibility analysis may be based on an assessment of aspects such as the demand for GP-led secondaries by the general investor community accessible to the GP- particularly those targeted as New Investors into the proposed Continuation Fund, the potential liquidity needs of LPs in a Legacy Fund from which trophy assets are to be transferred-, as liquidity constraints among these may make them more amendable to providing relevant approvals to proceed with the secondaries transaction-; and the technical and practical feasibility of the transaction.

In practice, GPs will be expected to pursue a GP-led secondaries transaction towards the set-up and operationalisation of a Continuation Fund only when other options for achieving the dual objective of 'delivering exits on assets held on portfolio by a Legacy Fund in its wind-down-phase, while continuing to hold and manage the same 'trophy assets' for future upside' have been thoroughly explored and dismissed [24]. Thus, GP-led secondaries will typically be utilised as an exit [and liquidity] tool of last resort. The GP will be required to provide a justification- to this effect - to the LP Advisory Committee of the Legacy Fund and Prospective New Investors (LPs) into the newly formed Continuation Fund at different stages of the transaction process, as described in subsequent sub-sections below.

After carefully analysing the Opportunity, the GP will decide whether, or not, to pursue the set-up and operationalisation of a Continuation Fund through a GP-led secondaries transaction.

Step 2: Notification to Legacy Fund LPs of a GP's intent to execute a GP-led transaction

The GP intending to set up a Continuation Fund and, after that, to transfer 'trophy assets' from a Legacy Fund to the Continuation Fund- through a GP-led secondaries transaction- will typically initiate a discussion with the LP Advisory Committee of the Legacy Fund in question, with intent to gauge willingness by these to back the endeavour. The discussion with LPs must occur before a GP commits time and resources to set up the Continuation Fund- as consent and waivers of conflicts of interests from the LP Advisory Committee are required for the GP-led secondaries transaction to proceed. In the earlier stages, the GP will aim to obtain approval "**in principle**" from the LP Advisory Committee to proceed with the GP-led secondaries transaction. After an "in principle" approval, the GP will develop a **formal proposal** to present to the LP Advisory Committee for **formal initial approval**.

[24] Clifford Chance. (2020). 'Decoding' the Secondary Market Part III: Annex Funds. Clifford Chance.

I. Rationalisation of the GP-led secondaries transaction

Before granting the GP **formal initial approval** for the GP-led secondaries transaction to proceed, the LP Advisory Committee of the Legacy Fund from which trophy assets shall be transferred into the Continuation Fund will expect the GP to provide the **commercial and financial rationale** for pursuing the GP-led secondaries transaction. The GP will present the rationale as a **formal proposal** for the Continuation Fund in an LP Advisory Committee meeting.

In building the **rationale for the Continuation Fund**, the GP will be expected by LPs to:

1. **Justify the decision to utilise a Continuation Fund to deliver exits and provide liquidity to LPs of the Legacy Fund as opposed to other exit routes, which could similarly achieve the same objectives (exit and liquidity**). Suppose a GP's argument for setting up a Continuation Fund is to deliver exits and liquidity for LPs in a Legacy Fund at the tail end of its life. In that case, the GP should provide clear evidence of why the Continuation Fund is the most viable route to deliver such exits [and liquidity for LPs] as opposed to other exit routes (IPO, secondary buyout, management buyout, trade sale).

2. **Justify the choice to set up a new vehicle (Continuation Fund) to allow the GP to continue holding interests in 'trophy assets' presently held in the books of the Legacy Fund rather than requesting an extension on the life of the Legacy Fund - which could similarly achieve the objective extending the hold period to reap from future asset upside.** Suppose a GP's argument for setting up a Continuation Fund is to retain control and management of 'trophy assets' to reap the future upside. In that case, a GP should provide a rationale for the choice to utilise a Continuation Fund- as a tool for continued exposure to trophy assets beyond the fixed term life of a Legacy Fund, as opposed to simply requesting the LP Advisory Committee for an extension on the life of the Legacy Fund. An extension to the Legacy Fund (typically 1 to 2 years) may also achieve the intent of reaping future upside on 'trophy assets', as the GP would still retain control of the asset, hence the need for a strong value proposition on the new vehicle (Continuation Fund).

3. **Explain the mechanics and operational plans for the proposed Continuation Fund**. The LP Advisory Committee may require that the GP provide information on the amount of fresh capital required to capitalise the proposed Continuation Fund, both to enable the newly formed Fund to purchase 'trophy assets' from the Legacy Fund and, after that, adequately provide follow-on capital to 'trophy assets'. In addition, the GP should articulate the "projected time to realisation". The GP must also clearly demonstrate solid fundamentals for the 'trophy assets' due for sale and transfer to the Continuation Fund and provide a clear strategy for continuing the value creation process that has previously generated significant upside in the 'trophy assets'[25]. Information on other fund mechanics may be provided here, such as the Continuation Fund term (typically 5 to 6 years) plus extensions (typically plus 2 to 3 years)[26]. Further, the GP may be expected to indicate anticipated fund economics, such as carried interest expectations (typically 25% to 30% on the realisation of gains) and expected management fees on the Continuation Fund, typically lower (0.5% to 1.25% per annum on capital invested) than those offered for managing primary funds (1.5%

[25] The value creation plan may entail operational improvements, or cost saving opportunities.
[26] Paul Hastings. (2022). Continuation Vehicles: Six month snapshot of the key terms of continuation vehicles. Paul Hastings

to 2.5% per annum on capital committed)[27, 28]. If available at this point, indicative information on plans for legal provisions such as key person provisions, no-fault removal provisions, removal for cause provisions, allowances for short-term borrowing and clawback provisions may be shared with the LP Advisory Committee[29].

4. **Demonstrate that the transfer of 'trophy assets' from the Legacy Fund to the proposed Continuation Fund will not result in a material loss for LPs in the Legacy Fund- whether they choose to liquidate their positions (Selling LPs) or roll these over (Rolling LPs) into the new vehicle (Continuation Fund).** The GP should clearly explain how the Continuation Fund will maximise returns for LPs in the Legacy Fund. Here, a GP must provide evidence and planned mechanisms for ensuring that LPs who choose not to liquidate (cash out) their positions on the exit of 'trophy assets' from the Legacy Fund but rather roll over interests from the Legacy Fund into an established Continuation Fund are "no worse off than when the Continuation Fund had not occurred"[30].

5. **Demonstrate the GP's intent to take on material risk in the Continuation Fund- particularly if the same GP requests that LPs in a Legacy Fund consider rolling over their interests from the Legacy Fund into a Continuation Fund- representing a material risk to LPs**. The GP must provide clear evidence of continued "skin in the game" in the newly formed vehicle, which will serve as an initial pitch to LPs of the Legacy Fund who may be considering rolling over interests into the Continuation fund once a sale and transfer of 'trophy assets' from the Legacy Fund is concluded. The GP may consider expressing to the LP Advisory Committee the GP's intent to re-invest –into the Continuation Fund - all GP Legacy Fund carried interest earnings realised from the Legacy Fund's sale of 'trophy assets' to the Continuation Fund. "A rollover of crystallised carried interest may mean a very significant commitment on the part of the GP, well above its original investment," in the Legacy Fund or particular assets due for sale and transfer[31, 32]. The International Limited Partners Association (ILPA) Guidelines recommend that "all carried interest accruing to the GP related to interests" from the Legacy Fund's sale of "trophy" assets to the Continuation Fund "be rolled into the new" Continuation Fund as capitalisation[33]. Exceptions may exist (see **Part 4: Considerations**).

6. **Disclose potential conflicts of interest likely to arise from the GP-led transaction and subsequent sale and transfer of 'trophy assets' from the Legacy Fund into the proposed Continuation Fund**. Significant conflicts of interest are around the [purchase] price of the ['trophy'] assets held by the Legacy Fund due for sale and transfer to the Continuation Fund. This as the GP is both the asset seller (fund manager of the Legacy Fund selling the asset) and the asset buyer (fund manager of the newly formed Continuation Fund buying the asset). As a seller, the GP hopes to obtain the highest possible purchase price for the ['trophy'] asset to maximise its own (crystallised carried interest) and LP returns (pro rata distributions) on the Legacy Fund. As a buyer, the GP aims for the lowest purchase price on the asset, as would be the case for any third-party secondaries transaction buyer.

[27] Wong, A., & Wong, I. (2022). Continuation funds emerge as attractive options for PE fund managers and investors. White & Case.
[28] Ashurst. (2023). Secondaries transactions in the funds sector. Ashurst.
[29] Paul Hastings. (2022). Continuation Vehicles: Six month snapshot of the key terms of continuation vehicles. Paul Hastings
[30] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[31] Ashurst. (2023). Secondaries transactions in the funds sector. Ashurst.
[32] Capital Dynamics. (2022). GP-led secondaries- reshaping the landscape for investors, fund managers and portfolio companies. Capital Dynamics.
[33] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.

As such, the LP Advisory Committee will expect the GP to justify decisions on the purchase price of the ['trophy'] assets held by the Legacy Fund and due for sale and transfer to the Continuation Fund. GP disclosures on ALL potential conflicts of interest and strategies for managing these to the LP Advisory Committee will be vital for the GP-led transaction to proceed - as proceeding is contingent on an LP Advisory Committee **waiver on conflicts of interests** (see **Part 4: Considerations**)[34].

7. **Provide Legacy Fund LPs with an outlook on the Legacy Fund once 'trophy assets' are sold, written off the Legacy Fund's books and transferred to a Continuation Fund**. For Single Asset [and in some cases Multiple Asset] Continuation Funds, only one or a portion of the Legacy Fund's ['trophy'] assets may be sold off and transferred to a Continuation Fund, leaving the Legacy Fund still holding interests in a few portfolio companies after the GP-led secondaries transaction is complete. As such, when presenting the rationale for the transaction, the GP must provide the LP Advisory Committee with a performance outlook on the Legacy Fund going forward and an indication of the quality of the remaining assets in the Legacy Fund. As the Legacy Fund will likely be at the tail-end of its life, a well-thought-out plan for delivering exits on the remaining assets held by the Legacy Fund should be provided.

II. Processing procedures and timelines for a notice of intent

By initiating a GP-led secondaries transaction towards the set-up and operationalisation of a Continuation Fund, the GP will, in essence, be "forcing the hand" of LPs invested in the Legacy Fund. LPs will be forced to make a quick decision, within a very short period, as to whether in the first place to approve the transaction to proceed, and second as to whether to cash out their interests in the existing Fund ("Selling LPs") or to roll over their interests as an investment into the Continuation Fund ("Rolling LPs")[35]. Further, following the GP's notice of intent, LPs with lean teams or teams not familiar with GP-led secondaries transactions may need time to either familiarise themselves with the complexities of the transaction, or to hire external expertise to assess the merits and demerits of the proposed secondaries transaction before providing the relevant approvals.

As such, when seeking **formal initial approval** to proceed with a GP-led secondaries transaction from the LP Advisory Committee of a Legacy Fund, a GP must provide the Committee with an adequate notice period to consider the request. Further, as holders of LP Advisory Committee positions may not be the ultimate final decision makers, they may need ample time to escalate the GP's request up the decision chain- which will be made easier by adequate advance notice[36].

The ILPA Guidelines recommend that the GP provide LPs of a Legacy Fund no less than a month's notice (**30 calendar days**) of intent to set up a Continuation Fund through pursuit a GP-led secondaries transaction. This will allow Legacy Fund LPs adequate time to thoroughly assess the GP's request and return their decision on the intended transaction through their respective election forms [37].

The process ends with a "no" or with **formal initial approval** from the Legacy Fund LP-base.

[34] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[35] Kastiel, K., & Nili, Y. (2023). Exhibit A: High-Class Conflicts. SEC.
[36] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[37] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.

Step 3: Appointment by the GP of an advisory team to guide the GP-led transaction

Once the LP Advisory Committee of the Legacy Fund provides the GP (Sponsor) with a **formal initial approval** to proceed with the secondaries transactions towards the set-up and operationalisation of a Continuation Fund, the GP may proceed to assemble the transaction advisory team.

I. Advisory team composition and roles

The advisory team may comprise third-party advisors, each playing a different role as follows[38]:

1. **GP-appointed legal advisors to structure the Continuation Fund and execute the GP-Led secondaries transaction**. The role of the legal advisors in the secondaries transaction will be to Structure (incorporate) the Continuation Fund and draw up relevant [legal] terms. The legal advisor will also analyse potential conflicts of interest likely to arise from a transaction in which the GP is both on the buy-side and sell-side (related-party transactions). For the latter, the legal advisor will be prudent to identify potential legal and regulatory restrictions on the proposed related-party transaction and, where these exist, devise [legal] strategies and mechanisms to manage said conflicts.

2. **GP-appointed tax advisors to provide relevant tax implication analysis during the structuring of the Continuation Fund**. These will work with legal advisors during the Continuation Fund Structuring process to provide relevant analysis on the tax implications to Legacy Fund LPs as relates to the Rollover of interests to the Continuation Funds, more so if "Rolling LPs" intend to maintain tax-neutral status in the newly formed Continuation Fund. These may also analyse the tax implications of the transaction as a "related-party transaction".

3. **GP-appointed financial advisors to execute the GP-Led secondaries transaction**. Hereafter referred to as "**placement agents**", these coordinate the [capital] fundraising process for the Continuation Fund and interface with Prospective New Investors (LP) into the Fund (investor relations). These will draw up a strategy and material for marketing the Continuation Fund, build up a [virtual] investor data room for the fundraising process, and then solicit bids- from Prospective New Investors (LPs)- for investment into the now-incorporated Continuation Fund. The [virtual] investor data room will typically contain relevant documentation availed to Prospective New Investors (LPs) into the Continuation Fund to enable them to seamlessly carry out their [secondaries] transaction due diligence processes once the GP makes an Offer.

[38] Vepsä, A. (2022). Finland: Continuation Funds As A Tool For Creating Liquidity. Mondaq.

II. Mechanisms for the payment of the advisory team

Costs associated with executing the GP-led secondaries transactions and transferring and selling 'trophy assets' from the Legacy Fund to the Continuation Fund will be ascribed to the Legacy Fund as "exit costs" rather than the GP's books. As such, the advisors would be assumed to work not solely in the interests and on behalf of GP in the transaction process, but also in those of the Legacy Fund- including the Fund's LPs[39]. Costs related to the set-up and operationalisation of the Continuation Fund will be ascribed to the new vehicle and are met by new investors into the vehicle and "Rolling LPs"[40].

III. Oversight over the activities of the advisory team

Appointed advisors will be subject to scrutiny from the LP Advisory Committee of the Legacy Fund- to ensure that their recommendations and actions are aligned with the interests of the Legacy Fund- more broadly, and those of the LPs invested in the Legacy Fund, and that the GPs' interests do not override these. Conflicts of interest and prior relationships and dealings between the appointed advisors and the GP should thus be disclosed to the LP Advisory Committee. In addition, the ILPA Guidelines recommend that the GP disclose to the LP Advisory Committee the terms under which the advisors have been engaged, including fees and scope of works[41].

GP-appointed advisors for the secondaries transaction will also be expected to avail themselves to the LP Advisory Committee throughout the transaction process – as needed – to provide clarifications and responses to aspects of, and questions arising from the transaction, including questions about strategies and tools employed for the management of conflicts of interest in the secondaries transaction process (legal advisors), and the merits of bids submitted by Prospective New Investors (LPs) into the Continuation Fund (placement agents) [42]. Further, members of the LP Advisory Committee may similarly appoint an independent counsel (legal advisors) to scrutinise the GP-led transaction, inviting comparisons in legal analyses and opinions.

Step 4: Preparatory activities by the GP and advisory team for the GP-led transaction

At this stage, the GP of the Legacy Fund - who is also the Sponsor of the Continuation Fund - and hereafter referenced as "**GP (Sponsor)**" - will work closely with the advisory team, comprising appointed legal, tax and financial advisors, to Structure the new Continuation Fund and prepare relevant material required for fundraising from Prospective New Investors (LPs). Some of these activities may be similar to those typically carried out when fundraising for a primary fund.

(See **Step 3** above for a description of some preparatory activities).

[39] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[40] Ashurst. (2023). Secondaries transactions in the funds sector. Ashurst.
[41] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[42] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.

Step 5: Marketing the Continuation Fund to prospective new investors - origination, review and selection

After appointing an advisory team, setting up (structuring) the Continuation Fund, and concluding all preparatory activities for the GP-led secondaries transaction, the GP (Sponsor) and the placement agent will proceed to the fundraising phase- at this stage, looking to source new Investors (LPs) to commit capital to the [newly formed] Continuation Fund. At this stage, the GP (Sponsor) may opt for a more passive role, relying on the appointed placement agent to execute the fundraising strategy.

I. Origination, shortlisting and selection of prospective new investors (LPs) into the continuation fund

To build a pipeline and generate a long list of Prospective New Investors (LPs) to be targeted as new investors in the newly formed Continuation Fund, the placement agent will either leverage the GP (Sponsor)'s existing LP relationships and contacts, or rely on a bidding process[43]. The LP long list may comprise specialised secondaries funds, funds of funds, or other traditional LPs with allocation quotas for secondaries investing. The longlist will be narrowed to under 10 target Investors (LPs).

In generating a shortlist of targeted Prospective New Investors (LPs) into the Continuation Fund, the placement agent will likely target single investors to invest wholesale in the Opportunity, or opt for a syndicated investment led by a lead counterparty (anchor investor), but supported by co-investments from other investors. For the latter, the placement agent will be careful to pitch the "lead counterparty" role to Prospective Investors (LPs) with solid credibility in the hopes that should these invest as lead counterparty, that besides providing a sufficient and substantive capital commitment (ticket size), their credibility will attract other Prospective New Investors (LPs) to syndicate a co-investment into the Continuation Fund[44]. After reaching an agreement with the lead counterparty, the placement agent can then proceed to form a syndicate of investors willing to participate alongside the counterparty.

II. High-level due diligence- 1st round of due diligence by prospective new investors (LPs) into the continuation fund

Generally, after an initial engagement with the placement agent, Prospective New Investors (LPs) will proceed to analyse the Offer to commit capital (subscribe) to the Continuation Fund as follows:

1. **Desktop due diligence on the GP's Offer by Prospective New Investors (LPs)**. Here, the Prospective New Investors (LPs) will rely on data prepared by the GP and the placement agent, and accessible through the GP's [virtual] investor data room to conduct the preliminary high-level due diligence on the GP, the proposed Continuation Fund Structure and 'trophy assets' proposed for transfer from the Legacy Fund to the Continuation Fund.

[43] Vepsä, A. (2022). Finland: Continuation Funds As A Tool For Creating Liquidity. Mondaq.
[44] Smith, C. (2022). A step-by-step guide to GP-Led deals. Private Equity International.

2. **Initial meeting called by Prospective New Investors (LPs) to discuss the GP's Offer.** If, based on the desktop due diligence exercise, the Prospective New Investors (LPs) are convinced of the potential for returns from the Continuation Fund, they will request an initial meeting with the GP (Sponsor) of the Continuation Fund. In the meeting, the Prospective New Investors (LPs) will seek to understand the GP (Sponsor) 's rationale for seeking to transfer one or more 'trophy assets' from the GP's Legacy Fund into a Continuation Fund. Further, the Prospective New Investors (LPs) will want to understand what makes said one or more 'trophy assets' (interests in portfolio companies) proposed for transfer from the GP's Legacy Fund into a Continuation Fund "so special" as warranting such effort and substantive expense as setting up a new vehicle and as necessitating recycling of assets previously held on portfolio by the GP under the winding down Legacy Fund (as opposed to setting up a successor fund and investing instead in fresh assets).

3. **Indicative bid on the GP's Offer by Prospective New Investors (LPs).** If convinced of the potential of the Opportunity, the Prospective New Investors (LPs) will proceed to submit to the GP (Sponsor) an **indicative bid** based on a **short-form term sheet**[45].

III. Deep due diligence - 2nd round of due diligence by prospective [new] investors (LPs) into the continuation fund

Following indicative bids received, the GP (sponsor) will invite select Prospective New Investors (LPs) to undertake a deep due diligence on the Opportunity. The deep due diligence process will be multi-layered and will be conducted by the Prospective New Investors (LPs) at **three levels** as follows:

1. **Level 1: Due diligence by the Prospective New Investors (LPs) at the GP fund manager level.** The Prospective New Investors (LPs) into a Continuation Fund will seek to assess the capability of the GP (Sponsor) and its existing team to effectively pursue enhanced value creation strategies (team experience and skills) on the 'trophy assets' underlying the secondaries transaction. Due diligence on the GP's team is in recognising that a highly competent GP (Sponsor) team will be vital in generating further returns and reaping from the future upside of 'trophy assets' to be transferred into the Continuation Fund.

2. **Level 2: Due diligence by the Prospective New Investors (LPs) at the portfolio company level.** Through the set up [virtual] data room, the GP will be expected to avail portfolio company disclosures to the Prospective New Investors (LPs) to facilitate company-level due diligence[46]. The Prospective New Investors (LPs) into a Continuation Fund will seek to ascertain the credibility of the GP's claims of underlying 'trophy assets' due for sale and transfer to the Continuation Fund as truly being crown jewels with potential for future upside. Prospective New Investors (LPs) may assess the strength of the management team of the portfolio companies underlying the transaction and the prospects and outlook for the industries in which the companies operate[47]. Further, due diligence activities may include a visit by the Prospective New Investors (LPs) to the premises and facilities of the portfolio companies underlying the set-up of the Continuation Fund, obtaining third-party

[45] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[46] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[47] Legal due diligence on both the GP and Portfolio assets at this level will be minimal.

references for the assets, and engaging external consultants to undertake relevant market research to ascertain market and growth outlook prospects provided by the GP[48].

3. **Level 3: Due diligence by the Prospective New Investors (LPs) at the Fund level (Legacy Fund).** The Prospective New Investors (LPs) may conduct fund-level due diligence to obtain an understanding of **1)** the follow-on capital requirements of the 'trophy assets' due for transfer to the Continuation Fund as an indicator for fund size requirements; **2)** the performance of the Legacy Fund as an indicator of the GP's track record and value creation capabilities; and **3)** the alignment between the GP (Sponsor) and the Legacy Fund LP-base, as such alignment will be needed to obtain approval of the secondaries transaction by the LP Advisory Committee- as necessary for transaction close[49].

IV. Pre-final bid negotiations between Prospective [new] Investors (LPs) and the GP (Sponsor) of the continuation fund

Upon completing the deep due diligence, Prospective New Investors (LPs) considering moving forward with the secondaries transaction may engage the GP (Sponsor) in negotiations to ensure alignment on the terms and conditions of a prospective investment into the Continuation Fund. The negotiations conclude with **side letters** issued on a bilateral basis by the GP (Sponsor) to New Investors (LPs) into the Continuation Fund with the side letters stipulating any agreed upon side arrangements.

While negotiations may be similar to those had in the fundraising process for primary funds, given the unique nature of the Continuation Fund, negotiations may additionally be informed by the following:

1. **The GP's capital commitment to the Continuation Fund,** in the form of a Rollover of crystallised carried interest. Here, the Prospective New Investors (LPs) will seek to ascertain whether the percentage of crystallised carried interest to be rolled over into the Continuation Fund by the GP- once the GP-led secondaries transaction is complete- is sufficient to "show skin in the game". If the crystallised carried interest for Rollover is less than 100% without valid justification from the GP, the negotiations may result in a request for an upward adjustment (see **Part 4: Considerations**).

2. **Terms and conditions in the Fund Agreement of the Continuation Fund.** Here, Prospective New Investors (LPs) will want to ensure "buyer and new investor protections" are enshrined in the Fund Agreement, such that the terms and conditions offered to "Rolling LPs" from the previous Legacy Fund are not materially more favourable than those offered to Prospective New Investors (LPs) into the Continuation Fund. Prospective New Investors (LPs) may request that the GP (Sponsor) provide access to the **side letters** issued to "Rolling LPs" from the Legacy Fund to inform the negotiation of their terms. Where terms are comparably unfavourable, adjustments may be requested.

3. **The "Floor" on the sale of interests by Legacy Fund LPs.** Here, the Prospective New Investors (LPs) into a Continuation Fund may have determined, through their own or third-party analysis, the "minimum percentage of interests [that would need] to be sold by

[48] Guryn, D., & Poldauf, P. (2022). The complexity premium in GP-led secondaries. Schroders Capital.
[49] Guryn, D., & Poldauf, P. (2022). The complexity premium in GP-led secondaries. Schroders Capital.

existing investors ("Selling LPs") to make the deal worthwhile" (Floor)[50]. In stride, at the negotiation, the Prospective New Investors (LPs) will seek assurances of the GP's ability to deliver a minimum threshold of Legacy Fund LPs to "Sell" their interests.

4. **The "Ceiling' on commitments by New Investors (LPs):** Here, Prospective New Investors (LPs) in a Continuation Fund may have determined the maximum amount of capital they are willing to or can commit to the newly formed Fund. This amount will be less than the total capitalisation required to operationalise the Continuation Fund. In stride, at the negotiation, the Prospective New Investors (LPs) will seek assurances of the GP's ability to either **1)** secure enough investments (Rolled Interests plus capital Re-Ups) from Legacy Fund LPs ("Rolling LPs") or **2)** obtain additional new investors to syndicate to meet the capital commitment targets for the Fund [51].

5. **Other potential areas of negotiation.** These vary and may be around treatment of uncalled capital commitments to the Continuation Fund in the event that these commitments are needed as security for Fund borrowing, Continuation Fund economics (management fees and carried interest) and the terms and conditions on the transfer of 'trophy assets' from the Legacy Fund to the Continuation Fund.

V. Final bids and capital commitment by Prospective New Investors (LPs) into the continuation fund

Once both the Prospective New Investors (LPs) into a Continuation Fund and the GP (Sponsor) are aligned on the terms and conditions of investment into the Continuation Fund, the Prospective New Investors (LPs) will submit **final bids** to the GP (Sponsor) indicating intent and commitment to subscribe and commit capital to the Continuation Fund. The GP and financial advisor will review the submitted final bids and select the final successful bidders to form the LP base for the newly formed Continuation Fund, pending consent and approval from the LP Advisory Committee of the Legacy Fund[52].

Step 6: Approvals of new investors (LPs) into the Continuation Fund by Legacy Fund LPs

The LP Advisory Committee of the Legacy Fund must approve an investment into a Continuation Fund by any Prospective New Investors (LPs). This consent is in the form of **final binding approval**[53]. The GP (Sponsor) shall be expected to present to the LP Advisory Committee the final bid(s) and transaction terms of the secondaries transaction as relates to capital commitments to the Continuation Fund by the Prospective New Investors (LPs) and allow adequate time for review. The ILPA guidelines provide an indicative timeline of **10 business days** for said LP review and communication of approval[54].

[50] Ahern, A. M., Anderson, G., & Anderson, G. (2020). Navigating the Nuances of Continuation Funds. Debevoise & Plimpton.
[51] Ahern, A. M., Anderson, G., & Anderson, G. (2020). Navigating the Nuances of Continuation Funds. Debevoise & Plimpton.
[52] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[53] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[54] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.

Step 7: Elective by Legacy Fund LPs to sell or rollover interests into the Continuation Fund

Final binding approval from the LP Advisory Committee for a GP to proceed with the transaction will allow the GP to close terms with newly obtained Investors (LPs) into the Continuation Fund.

Further, the final binding approval from Legacy Fund LPs will allow capital commitments (cash) from the newly acquired Investors (LPs) to be used by the Continuation Fund to purchase the 'trophy assets' that triggered the secondaries transaction in the first place from the Legacy Fund at a pre-determined purchase price based on discounts or premiums on asset valuation. The sale of the 'trophy assets' by the Legacy Fund to the Continuation Fund signifies an exit of the assets (interests in portfolio companies) by the Legacy Fund.

At this point, the GP – as fund manager of the Legacy Fund, has, in essence, **delivered an exit on assets held in the Legacy Fund** and can now proceed to distribute cash proceeds from the sale to Legacy Fund LPs, as well as to claim the GP's carried interest earnings.

However, before LP distributions from the transaction are made, LPs of the Legacy Fund must communicate to the GP of the Continuation Fund- who is the fund manager of the Legacy Fund- in advance and elect how they want their distributions from the sale [and exit] of the 'trophy assets' (interests in portfolio companies) by the Legacy Fund to the Continuation Fund to be treated. To facilitate the elective process, the GP will typically provide Legacy Fund LPs with a **documentation package** containing an **information memorandum** which will outline relevant transaction information, the **Fund Agreement** for the Continuation Fund, and **subscription agreements** defining the terms and conditions for accepting an investment from "Rolling LPs" into the Continuation Fund[55]. The Fund Agreement will outline the proposed final terms and conditions of the prospective partnership in the Continuation Fund- outlining how these may differ from those offered in the (original) Fund Agreement utilised for the Legacy Fund [56].

The documentation package will also include an **election form**. Using the election form, Legacy Fund LPs may opt to **1)** cash out on their distributions ("Selling LPs"); **2)** partially cash out their distributions while rolling another portion of said [cash] distributions to the Continuation Fund ("Selling/" Rolling LPs" ") or; **3)** fully Rollover said [cash] distributions to the Continuation Fund as an Investor ("Rolling LPs") - potentially with re-ups on capital commitments into the new Continuation Fund above and beyond the value of distributions obtained from the exit delivered by the Legacy Fund.

Legacy Fund LPs must communicate the decision to sell or rollover to the GP before Step 8 can be executed. The ILPA guidelines provide an indicative timeline of **30 calendar days** in which LPs are expected to elect to either sell or rollover interests in a Legacy Fund into a Continuation Fund [57, 58].

[55] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.
[56] Gannon, L., Yeung, A., & Kharwadkar, T. (2023). ILPA issues Guidance on Continuation Funds. DLA Piper.
[57] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[58] Burdett, J., Unger, J., & Asplund, J. (2020). Liquidity issues in private funds- General Partner-led solutions. Thomson Reuter.

Step 8: Deal close and transfer of assets from the Legacy Fund to the Continuation Fund

The transaction can be finalised once Legacy Fund LPs decide to withdraw ("Sell") or transfer ("Roll Over") their holdings and all necessary preconditions have been met (including obtaining the **final binding approval** from the LP Advisory Committee). The final step involves the execution of the transaction and transfer documents alongside the Continuation Fund **subscription agreement**.

At this point, 'trophy assets' (portfolio companies) are written off the books of the Legacy Fund and transferred to the books of the Continuation Fund. To close the secondaries transaction, the Continuation Fund pays the Legacy Fund the equivalent of the purchase price of the 'trophy assets'. After that, cash received by the Legacy Fund from the sale of 'trophy assets' signifies **an exit on sold assets** by the Fund, implying **an exit on assets has been realised** and allowing (cash) distributions to be made to Legacy Fund LPs as per LPs instructions to either Roll or Sell (as in **Step 7** above) and for the GP to claim carried interest. Meanwhile, the new Continuation Fund takes on the responsibility for holding (owning) and managing the 'trophy assets' (portfolio companies)[59].

As the GP (Sponsor) – and now fund manager of the Continuation Fund, was/is also fund manager of the Legacy Fund from which 'trophy assets' were transferred, the underlying **management of the 'trophy assets' (portfolio companies) remains with the same GP**-, but now under a newly formed Fund- representing the GP's continuity in holding and managing the asset towards value creation to reap from future upside.

[59] Vepsä, A. (2022). Finland: Continuation Funds As A Tool For Creating Liquidity. Mondaq.

PART 4: Considerations | Continuation Funds

Potential Transaction Issues and Remedies

Consideration 1: Conflicts of interest considerations

I. Disclosures and information transparency

Issue: A GP-led transaction is a **related-party transaction**. As such, the GP is both the buyer of 'trophy assets' from a Legacy Fund and the seller of the same assets to a Continuation Fund and thus holds a substantive information asymmetry advantage. GPs know more about the underlying assets of a Legacy Fund due for sale and transfer than the Legacy Fund LPs and Prospective New Investors into the Continuation fund. They may abuse this knowledge and information asymmetry to their advantage.

Remedy: To provide Legacy Fund LPs (whether 'Rolling' or 'Selling') and Prospective New Investors (LPs) into the newly formed Continuation Fund assurances of the integrity of the GP-led secondaries transaction, the GP should be transparent with transaction-related information to all relevant parties both before, and during the process of executing the secondaries transaction.

The itemised list of potential disclosures for the parties to the secondaries transaction is as follows[60, 61]:

Disclosures to the Legacy Fund LPs	Disclosures to Prospective New Investors (LPs)
1. The mechanics and nature of the prospective Continuation Fund, including selected 'trophy assets' due for sale by the Legacy Fund to the Continuation Fund, the rationale for selecting the specific assets, the rationale for choosing to exit the assets through a Continuation Fund rather than other exit options, and the process envisaged for executing the GP-led secondaries transaction. 2. All conflicts of interest likely to arise from the transaction, whether or not these are waived by the underlying Fund Agreement of the Legacy Fund or not. Disclosures will inform the LP Advisory Committee whether or not to provide conflict waivers for the transaction to proceed. 3. Access to the data room set up by the GP to market the Continuation Fund. Legacy Fund LPs will want to closely monitor the transaction progress to ensure transaction alignment with their interests. 4. Final bids submitted by Prospective New Investors to the GP (Sponsor) for Capital Commitments to the Continuation Fund. In addition, the terms offered by the GP to new investors into the Continuation Fund (**side letters**). Both "Rolling LPs" and "Selling LPs" in the Legacy Fund will want to ensure that the GP does not "favour the interests of potentially new investors" at their expense. 5. Mechanisms used to price the 'trophy assets' (interests in portfolio company interests) sold by the Legacy Fund to the Continuation Fund. Legacy Fund LPs – particularly "Selling LPs"- will be keen on ensuring the assets are not **under-priced** at their expense.	1. The mechanics and nature of the prospective Continuation Fund, including selected 'trophy assets' due for sale by the Legacy Fund to the Continuation Fund, and the rationale for selecting those specific assets. 2. Access to the data room set up by the GP to market the Continuation Fund. New LPs will want access to conduct high-level and deep due diligence on the Opportunity. 3. The terms offered by the GP to Legacy Fund LPs opting to roll over their interests into the newly formed Continuation Fund (**side letters**). Prospective new Investors into the Continuation Fund will require this information for comparability purposes when negotiating terms of their investment into the new vehicle with GPs as shall be prescribed in their own side letters. New investors into the Continuation Fund will review the terms offered to "Rolling LPs". New Investors will want to ensure that "Rolling LPs" are not benefitting from better terms than those offered to new Investors at the expense of said new Investors. 4. Mechanisms used to price the 'trophy assets' (interests in portfolio companies) sold by the Legacy Fund to the Continuation Fund. The Prospective New Investors into the Continuation Fund will be keen on ensuring the assets bought from the Legacy Fund are not **overpriced** at their expense.

Source: Author (2023) Adapted from various Sources
Note: further disclosure items may be obtained from the ILPA Guidelines (2023), **Page 7**

[60] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[61] Kastiel, K., & Nili, Y. (2023). Exhibit A: High-Class Conflicts. SEC.

II. Valuation and price determination mechanisms

Issue: In a GP-led transaction, the GP is the fund manager of both the Fund selling the asset (Legacy Fund) and the Fund buying the asset (Continuation Fund)- despite the two vehicles standing as separate and distinct legal entities. As such, as a buyer- through the Continuation Fund, the GP will aim for a bargain in the form of a low purchase price for the trophy asset. **The price will typically be set at a discount or premium of the asset's Net Asset Value (NAV).** As a seller, through the Legacy Fund, the GP will aim to obtain the highest possible return on investment from the asset and will consider a high selling price on the asset most favourable from a returns perspective, which represents a contradiction.

The contradiction often yields suspicions over the mechanism used by a GP to determine a fair price for the trophy asset underlying a GP-led secondaries transaction, particularly as mispricing on either the "sell" or "buy" side will be advantageous for the GP who happens to be both the asset seller and asset buyer. On the other hand mispricing of an asset underlying a secondaries transaction could pose a disadvantage and loss for the LPs of the Legacy Fund, particularly 'Selling LPs' (asset sellers) if the asset is sold at an amount less than its fair value, or for the LPs investing into the new Continuation Fund (asset buyers) if the asset is purchased at an amount higher than its fair value[62].

Remedy: To remove all doubts regarding the mechanisms used by the GP to determine the price of assets due for sale by a Legacy Fund to a Continuation Fund and provide assurances of the use of fair pricing mechanisms in the related-party transaction, besides LP Advisory Committee oversight over the GP led secondaries transaction- as a check and balance-, the following are common remedies[63]:

1. **Independent third-party valuations**: Valuation of underlying assets for sale may be an issue of contention in a GP-led secondaries transaction, as different valuation methodologies are employed across different private equity firms. As such, it may be prudent for a GP to **a)** determine whether the foundational documentation (Fund Agreement) for the Legacy Fund mandates that an LP Advisory Committee review GP valuations of assets held on portfolio, such that these can audit and approve GP valuations of assets underlying the GP-led secondaries transaction, and **b)** the GP engage an independent valuation firm to "perform a fundamental valuation on each of the individual assets" due for sale from the Legacy Fund, and ensure NAVs reflect reality [64, 65, 66].

2. **Independent fairness opinions**: The GP and advisors to the secondaries transaction may choose to obtain a fairness opinion from an independent advisor who would independently verify to all parties in the transaction "that the price offered for the assets is based on an underlying valuation that falls within a reasonable range" [67]. Further, to ensure and enhance the integrity of the fairness opinion, the GP should disclose to all parties "any material business relationship it has with the provider" of the opinion [68, 69].

[62] Metcalfe, G., Edwards, A., Boyce, C., & Protheroe, I. (2023). Continuation funds – some key considerations. Freeths.
[63] Clifford Chance. (2020). 'Decoding' the Secondary Market Part V: GP Led Transactions. Clifford Chance.
[64] Hartt, S., & Singh, B. (2023). White Paper: GP-Led Secondaries. MEKETA Investment Group.
[65] Clifford Chance. (2020). 'Decoding' the Secondary Market Part III: Annex Funds. Clifford Chance.
[66] Lee, D. (2020). The case for fairness opinions in GP-led secondaries. Secondaries Investor.
[67] Rucker, J. J. (n.d.). Continuation Funds: Valuation and Fairness Opinion Considerations. VRC.
[68] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[69] Kozlowski, J. (n.d.). To Continue or Not to Continue: The Rise of Continuation Funds. JLB Online.

3. **Parallel third-party transactions**: The GP may utilise the principle of precedence by availing verifiable evidence of similar asset valuations and asset pricing for similar prior sales of comparable assets by the GP/Legacy Fund to other third parties at comparable prices to those being offered for assets due for sale and transfer by the Legacy Fund to the Continuation Fund. The concept resembles the "arm's length principle" in transfer pricing justifications for related-party transactions[70].

4. **Full disclosure on the transaction.** Related to the 'disclosures and information transparency' component described above, during the execution of the secondaries transaction, the GP and the transaction advisors should ensure equality of access to information between the asset buyers (i.e. new LPs considering investing in the Continuation Fund), and asset sellers (Legacy Fund LPs). Information transparency and full access on both the buy and sell sides will be vital to building confidence in the fairness and validity of the price set for selling the 'trophy assets'[71].

5. **Anti-embarrassment clauses**. Anti-embarrassment clauses are typically used in Merger and Acquisition (M&A) transactions to ensure a party exiting their interests in an asset through a sale to another party – in this case, "Selling LPs" of a Legacy Fund – has the option to – even after the transaction is concluded – readjust the original sales price to reflect the actual value of the asset – if such an asset value is discovered after the fact – and request that the buyer of the asset pay the seller the amount equivalent to the difference between the original purchase price and the now readjusted purchase price. Anti-embarrassment clauses will typically be valid for one year from the date a transaction (sale) is concluded. In a GP-led secondaries transaction, such clauses may give "Selling LPs" comfort of the mechanisms used to determine asset pricing and provide them further assurances that the asset is not being sold by the Legacy Fund to the Continuation Fund at a price lower than fair value- at their expense[72] while guaranteeing an avenue for recourse.

6. **Competitive bid/ auction process**: Lastly, a typical GP-led transaction is subject to a process in which secondaries buyers (Prospective new Investors/LPs) auction or competitively bid to purchase interests in 'trophy assets' through committing capital to a Continuation Fund. Under the competitive bid/ auction process, Prospective New Investors (LPs) into a Continuation Fund will determine what investment to commit into the Fund based on an independent due diligence process of underlying 'trophy assets' due for sale and transfer from the Legacy Fund to the Continuation Fund. This, in essence, presents the GP (Sponsor) with multiple Offers/bids, which may serve as a good indicator of what the market perceives as a fair value on the assets underlying the secondaries transaction[73].

[70] Phillips, D. W., & LLP, V. (2023). Continuation Funds - Key Considerations. Lexology.
[71] Phillips, D. W., & LLP, V. (2023). Continuation Funds - Key Considerations. Lexology.
[72] Davies, G., & Fairfield, G. (2023). Anti-embarrassment clauses: post-closing protection in M&A. Reuters.
[73] Samman, F., Skandakumar, K., & Butler-Jones, A. (2022). Managing and mitigating conflicts of interests in GP-led transactions. Reuters.

III. Buyer protection and seller responsibilities

Issue: Rolling Legacy Fund LPs, like the GP, are inherently conflicted in GP-led secondaries transactions as they will benefit from the sale of the asset by the Legacy Fund through receiving distributions from the exit of the asset, as well as benefit from the purchase of the asset by the Continuation Fund, as LPs Rolling their interests and to form part of the LP-base of the new Fund. Therefore, their decisions and approvals during the transaction process may be subject to bias.

Remedy: To provide all parties to a secondaries transaction, mainly "Selling LPs" and New Investors, assurances during a secondaries transaction, that "Rolling LPs" are making decisions and acting in the best interests of the Legacy Fund –where they are asset sellers-, and similarly, in the best interests of the Continuation Fund- where they are asset buyers- the following are the commonly used strategies:

1. **Warranty and Indemnity (W&I) Insurance.** New Investors will want a Warranty- the right to claim damages if, after the fact, they realise an asset sold to a Continuation Fund they have interests in was misrepresented and overpriced by the Legacy Fund. Similarly, "Selling LPs" of a Legacy Fund will want a Warranty- the right to claim damages if, after the fact, they realise an asset sold by the Legacy Fund they had interests in -which they have now cashed out on - was under-priced and sold to the Continuation Fund at less than it is worth at their expense. Hence, in both instances, it is legally possible for the Continuation Fund to sue the Legacy Fund and vice versa for damages. In such a scenario, a "Rolling LP" who has LP interests in both Funds- would, in a legal suit comprising 'Continuation Fund' Versus 'Legacy Fund' – and vice versa- in essence, be suing oneself. For both scenarios, "Rolling LPs" will thus seek Indemnity to shield and protect themselves – financially- from warranty claims arising from either the asset-buyer or asset-seller side. It is thus common practice to take out and use W&I Insurance for GP-led secondaries transactions concerning the set-up of the Continuation Fund[74].

2. **"Rolling LPs" Recusals**. To address the conflicts of interest associated with "Rolling LPs" being both on the buy-side and sell-side of a GP-led secondaries transaction, some "Rolling LPs" may opt to abstain from LP approvals related to the secondaries transaction.[75, 76].

[74] Interview with Ed Ford and Sacha Goftond-Salmond, Spotlight on GP-Led secondaries. The Unquote Private Equity Podcast.
[75] Samman, F., Skandakumar, K., & Butler-Jones, A. (2022). Managing and mitigating conflicts of interests in GP-led transactions. Reuters.
[76] McMenamin, K., & Gofton-Salmond, S. (2022). The evolution of the GP-led market. CFA Society United Kingdom.

Consideration 2: Fund economics considerations

I. Crystallised carried interest from the exit delivered on the legacy fund and carried interest earnings rollover into the continuation fund

The rule: On exit of an asset from the Legacy Fund, through the sale of interests in the asset to the Continuation Fund, the GP will be entitled to claim carried interest from the performance of the Fund. The ILPA guidelines recommend that 100% of the carried interest earned by the GP from the secondaries transaction be rolled over into the Continuation Fund to demonstrate skin in the game [77, 78].

The exception to the rule: There is one exception to the above rule- namely, where there are **Carried Interest Arrangements** within the GP's private equity firm, and some employees under the arrangements have since ceased employment with the firm. It is common for private equity firms to have arrangements for allotment of carried interest earnings within members of the GP's team- typically distributed by order of seniority to partners, senior investment professionals, and occasionally senior associates and administrative staff such as Chief Operating Officers and Chief Financial Officers. Where such arrangements exist, and a member of a GP's team has, at the time of the secondaries transaction, since ceased employment with the private equity firm- for whatever reason, they retain entitlement to carried interest distributions based on a pre-determined allocation formula[79]. In this case, where such a person is no longer with the GP's private equity firm- on the sale of trophy assets by the Legacy Fund to the Continuation Fund, their carried interest share can be liquidated and handed over to them. Hence, the GP's carried interest rolled over into the Continuation Fund as a capital commitment will be less (Net) the pay out to former GP firm employees.

II. Management fees and carried interest fee structure on the continuation fund

Management fees: Management Fees due to the GP (Sponsor) for management of the Continuation Fund will typically be in the range of **1% to 2%,** charged on invested capital and NOT on committed capital[80]. This is lower than the 2% standard Management Fee terms for the typical primary Fund. The lower management fees are reflective of the "mature nature of the asset"[81, 82].

Carried interest: As the Continuation Fund holds 'trophy assets' (unlike a 'Zombie Fund', which will typically hold distressed assets), GPs will tend to request a higher carry percentage than the 20% typical of primary funds. The higher carry ('super carry provision') may feature tiered carry ranging from **25% to 30%,** claimed by the GP in the event that the Continuation Fund reaches its return targets[83, 84].

Appendix B captures further details on Fund Management Fees and Carried Interest.

[77] ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA.
[78] Metcalfe, G., Edwards, A., Boyce, C., & Protheroe, I. (2023). Continuation funds – some key considerations. Freeths.
[79] Persaud, A. N. (2015). Private Equity's Pixie Dust: Carried Interest Arrangements. Sixteenth Annual Private Equity Forum.
[80] Paul Hastings. (2022). Continuation Vehicles: Six month snapshot of the key terms of continuation vehicles. Paul Hastings.
[81] Financial Times. (2022). Selling to yourself: the private equity groups that buy companies they own. Financial Times.
[82] O'Shea, J. (2023). Continuation Funds: Key Considerations. Davies.
[83] Financial Times. (2022). Selling to yourself: the private equity groups that buy companies they own. Financial Times.
[84] Wong, A., & Wong, I. (2022). Continuation funds emerge as attractive options for PE fund managers and investors. White & Case.

Consideration 3: Legal, regulatory and tax considerations

I. Capital markets and tax regulatory scrutiny on the related-party transaction

As with any other related-party transaction, the GP executing a GP-led secondaries transaction to sell assets (interests in portfolio companies) to itself - as the Manager of the selling fund (Legacy Fund) and buying Fund (Continuation Fund) - will be subject to regulatory scrutiny. The nature and depth of scrutiny differ by jurisdiction but will often be remedied through compliance with the transaction disclosure and reporting requirements set by regulators on related-party transactions.

II. Tax considerations on the rollover of interests of legacy fund LPs into the new fund

A secondaries transaction may affect the tax-neutral status of Legacy Fund LPs rolling over their interests to the Continuation Fund. This can be remedied in structuring to ensure "efficient tax rollover treatment where possible". New Investors (LPs) into the Continuation Fund will be keen on ensuring they "are not acquiring assets with significant built-in taxable gains". The transaction's tax considerations are complex and need to be carefully considered[85]. Further analysis on tax considerations may be obtained from PWC (2021) *Keeping Up with Alternative Investment Funds*. **Page 3-5**.

III. Competition and anti-trust approvals triggered by the related-party transaction

GP-led transactions may be subject to jurisdiction-specific Competition and Anti-Trust notifications and approvals, particularly where the transaction is interpreted as constituting a "change of control"[86].

[85] Clifford Chance. (2020). 'Decoding' the Secondary Market Part V: GP Led Transactions. Clifford Chance.
[86] Clifford Chance. (2020). 'Decoding' the Secondary Market Part V: GP Led Transactions. Clifford Chance.

PART 5: Conclusions | Continuation Funds

GP-led secondaries are gaining increasing acceptance by GPs, and LPs are becoming a more commonly used strategy in the exit toolbox available to GPs, with the first notable momentum seen in the 2021 to 2023 period. For instance, in its Secondary Market Report 2022, Lazard (2022) notes that *"GP-led transactions comprised ~43% of the secondary market in 2022, with continuation funds (~75% of the GP-led market) now firmly established alongside IPOs and M&A as a route to liquidity for GPs*" – signifying the growing importance of Continuation Funds as an exit tool[87].

As Continuation Funds gain increasing recognition as an exit tool available to GPs, understanding when and how to execute a GP-led secondaries transaction will be vital, particularly in cycles characterised by a tough exit market. GPs considering this form of transaction will do well to take note of the following:

1. **Manage conflicts of interest and exercise business integrity**. The transaction that facilitates the set-up and operationalisation of the Continuation Fund – the GP-led secondaries transaction – is inherently a related-party transaction. Conflicts of interest must be flagged, disclosed and carefully managed during the transaction.
2. **Manage buyer and seller suspicions and build trust during the transaction.** The GP-led secondaries transaction that leads up to the set-up and operationalisation of the Continuation Fund is one in which all parties on the buy side and sell side of the transaction are suspicious of each other's intentions- with asset pricing the central issue of contention. Transparency, disclosures, and other tools highlighted in Part 4 of this document (Considerations) will be vital in managing and dispelling suspicions.
3. **Obtain a commitment of investment into the new vehicle from Legacy Fund LPs**. A Continuation Fund depends on having a minimum number of LPs in an existing Legacy Fund, rolling over their interests into the newly formed Continuation Fund ("Rolling LPs"). Convincing a minimum number of LPs to Roll will be necessary for transaction success, particularly as most LPs will be caught by surprise by the GP's expression of intent to pursue a GP-led secondaries transaction towards the set-up of a Continuation Fund. Building a solid rationale for the Continuation Fund, mainly focusing on the quality of the assets and potential returns, will be critical to convincing Legacy Fund LPs to Roll.
4. **Obtain competent and experienced transaction advisors**. Executing GP-led secondaries transactions is a relatively novel and complicated practice and endeavour. Obtaining competent legal, tax, and financial advisors with strong technical acumen and track record to execute the transaction may be essential to a successful transaction close.
5. **Keep track of the ever-changing regulatory landscape**. At the time of writing this white paper- the possibility of the continued adoption of Continuation Funds as a private equity exit tool remained largely unclear, particularly in light of increased regulatory scrutiny over the transactions. For instance, in 2023, the US Securities and Exchange Control (SEC) amended its Private Advisor Rules, prescribing a mandatory fairness opinion for asset pricing related to GP-led secondaries transactions to set up and operationalise Continuation Funds [88]. In contrast, European, Asian, African and other jurisdictions have yet to implement similar regulations[89]. Thus, GPs and their advisors must keep up-to-date with regulatory developments on Continuation Funds and the GP-led secondaries transactions that operationalise them. A changing regulatory landscape may also apply to jurisdiction-specific regulations on reporting and disclosures on related-party transactions.

[87] Lazard. (2022). Secondary Market Report 2022. Lazars.
[88] Dayal, M. (2023). Private Equity's 'Fourth Exit' Crimped by SEC Plan, Lawyers Say. Bloomberg.
[89] Farman, M. (2022). Europe a 'wild west' when it comes to running continuation fund processes. Secondaries Investor.

PART 6: Appendices

Appendix A: Sample Term Sheet for a Continuation Fund

The following sample **term sheet** is illustrative and sourced from Paul Hastings (2022)[90].

Clause	Provisions
Fund	Continuation Fund LP (the "Partnership"). Additional parallel, feeder, or alternative investment vehicles may be established as required for legal, regulatory or tax reasons (together with the Partnership, the "**Fund**").
Investment Objective	The primary objective of the partnership is to generate medium to long-term returns for its investment in Target Company Ltd (the "**Portfolio Company**").
General Partner	Continuation Fund GP Ltd, the general partner of the partnership (the "**General Partner**").
Limited Partners	The limited partners of the partnership (the "**Limited Partners**"), including the re-investing investors (the "**Re-investing Investors**") and third-party investors (the "**Syndicate Investors**").
Manager	Sponsor LLP, the Manager of the Partnership, who has been appointed to provide management services to the General Partner with respect to the partnership (the "**Manager**").
Carried Interest Partner	Carry LP will be entitled to receive distributions of Carried Interests (the "**Carried Interest Partner**").
Advisory Committee	The General Partner will invite the representatives of investors to join the advisory Committee as voting members (the "**Advisory Committee**"). The Advisory Committee will meet as required to consult the General Partner as to the partnership's performance and consider any potential conflicts of interest.
Term	The partnership has a term of five (5) years (the "**Term**") from the date of the closing, which may be extended for up to two (2) additional one-year periods subject to prior approval of the Advisory Committee.
Management Fee	The Manager shall receive a management fee of 1% of the invested capital of the partnership throughout the initial 5-year Tern ("**Management Fee**"). The Management Fee shall be negotiated in good faith by the General Partner and the Advisory Committee upon the occurrence of the following: a) Any Term extension; and b) The commencement of the liquidation process of the partnership.
Management Fee Offset	One hundred per cent (100%) of any Partnership investment-related fees and commissions received directly or indirectly by the Manager (other than the Management Fee and Carried Interest) shall be offset against the Management Fee.
Commitments	Total commitments to the partnership will not exceed $700 million (the "Commitments") being the sum of:

[90] Paul Hastings. (2022). Continuation Vehicles: Six month snapshot of the key terms of continuation vehicles.. Paul Hastings

Clause	Provisions
	a) $500 million (the "**Purchase Price**"); and b) Up to $150 million of undrawn commitments (the "Unfunded Commitment") which shall be used for follow-on commitments in the Portfolio Company ("**Follow On Investments**") and fund expenses (including Management Fee), All Limited Partners will participate on a pro rate basis in respect of both limbs of Commitments.
Currency	All commitments, distributions and calculations with respect to the partnership will be denominated in Dollars ($).
Borrowing	The partnership may borrow the money for up to 12 months for purposes including bridging, working capital or liquidity purposes. Borrowing and any amount outstanding under guarantees shall not exceed thirty per cent (30%) of the aggregate Commitments. The partnership is authorised to grant security over any of the assets of the partnership, any Unfunded Commitments, the right to deliver drawdown notices and the right to exercise any remedies against "Defaulting Investors" provided for under the limited partner agreement (the "**Partnership Agreement**")
Recycling	The General Partner may determine in its sole discretion to retain the use of distributable proceeds instead of issuing drawdown notices of Limited Partners as long as a drawdown notice could still be issued at the time for the proposed use of such funds. The General Partner undertakes that the invested capital, including any re-investments from recycled distributable proceeds, shall not exceed one hundred and twenty per cent (120%) of the partnership's aggregate Commitments.
Distributions	Investment proceeds will be distributed in the following order of priority: a) Return of Capital: First, one hundred per cent (100%) to the Limited Partners until the cumulative amount distributed to the Limited Partners (taking into account all prior distributions made pursuant to this limb (a)) is equal to the Limited Partners' aggregate capital contributions at the time of such distribution. b) Relevant Return: Second, between the Limited Partners and the Carried Interest Partner in the ratio specified in the table below, until the cumulative distributions to the Limited Partners are sufficient to provide an annualised effective internal rate of return ("**Net IRR**") and (where applicable) a net multiple on invested capital ("**Net MoIC**") on the capital contributions of the Limited Partners as specified in the table below (each a "**Relevant Return**"); c) Catch-Up and Carried Interest: After each Relevant Return is satisfied, the Carried Interest Partner's carried interest percentage will be increased, and the Carried Interest Partner will receive catch-up distributions according to the Relevant Return that has been satisfied:

LP/GP Split	Relevant Return	Carried Interest	GP-Catch-Up
90:10	Net IRR 10%	10%	100%
85:15	1.5x Net MoIC and Net IRR	15%	100%
80:20	2.0x Net MoIC and Net IRR	20%	100%

Clause	Provisions
Carried Interest Clawback	Upon the termination of the partnership, the General Partner will undertake a calculation pursuant to the formula provided in the "Distributions" section of this term sheet to determine whether there has been any overpayment of the Carried Interest to the Carried Interest Partner. To the extent that there has been an overpayment, the Carried Interest Partner will return to the partnership (which will, in turn, distribute to the investors) any excess amounts received by the Carried Interest Partner.
Establishment expenses	The partnership will bear all legal, organisational and offering expenses, including the out-of-pocket expenses of the General Partner and the Manager and the Agents, actually incurred in the formation of the Partnership and the General Partner, and the negotiation, execution and delivery of the Partnership Agreement and related agreements up to a maximum of $3,500,000.
On-going expenses	The partnership will bear all its on-going expenses and expenses incurred during the life of the partnership, including on-going legal, audit, regulatory and administration fees, any costs and expenses incurred with respect to the third parties providing services to the partnership and all expenses associated with the acquisition, restructuring and disposal of investments. The General Partner of the Manager will be responsible for all of its own normal overhead and administrative expenses, including salaries and benefits, rent and office furniture and shall be entitled to recover such costs from the partnership.
Defaulting Investor	A limited partner that defaults with respect to its obligation to make capital contributions (a "**Defaulting Investor**") shall be liable to interest on the amount outstanding at the rate equal to EURIBOR plus four per cent (4%) for the period from the drawdown date until the date on which such outstanding amount and interest thereon shall have been paid in full ("**Default Interest**"). In the event that the Defaulting Investor has not cured the default within 30 days of the date of notice from the General Partner requiring it to do so, the General Partner shall have the right: • To forfeit the capital contribution of the Defaulting Investor, in which case the rights of such Defaulting Investor shall be limited to the right, on termination of the Fund, to payment (after all other investors have received payment of their capital contributions and the first hurdle and Carried Interest Partner has received the first catch up of the lesser of the amount it has advanced to the Fund and the fair market value of its interest at the time of the distribution; or • To act as selling agent and the Defaulting Investor's appointed attorney in disposing of the interest of the Defaulting Investor to a third party at such reasonable price agreed between the General Partner (acting in good faith) and the relevant third party. The availability of the remedies set out above is without prejudice to any other legal or equitable remedies the General Partner may have in respect of any default under the terms of the Partnership Agreement.
Removal of clause	The appointment of the general partner may be terminated by a vote of greater than two-thirds of the interest of the Limited Partner in the event that there is a final determination that such termination is a result of a cause-effect.

Source: Paul Hastings (2022) Continuation Vehicles: Six-month snapshot of the key terms of continuation vehicles.

Appendix B: The fund economics of Continuation Funds

Component	Terms
Fund Term (years)	5 to 6 years fixed term with optionality for a 1 plus 1 plus 1 extension.
GP (Sponsor) Commitment	– 100% Rollover of Crystallised Carried interest earned from Legacy Fund accruing from the sale of assets to the Continuation Fund.
Management Fees	– 1% to 2% of invested capital (and not committed capital); **OR** – No management fees charges (0%), but rather an ongoing asset (portfolio company) monitoring fee of 1.5% of the Continuation Fund Size. **OR** – No management fees charges (0%), but rather a one-off transaction fee.
Hurdle ('Required Rate of Return) and Carried Interest	– Waterfalls with Ratchetted carry mechanic. – Waterfalls that include both IRR and MoIC return thresholds. – 100% GP Catch-up at each level.
Fund management costs and expenses	Fund management costs and expenses may be capped at a fixed amount per annum, over and above which costs are payable by the GP (Sponsor).
Provisions	LP Advisory Committee: All Continuation Funds have an LP Advisory Committee. Key person provisions: Optional, some do, some don't have this provision. No-Fault removal provisions: Optional, some do, some don't have this provision. Removal for Cause: All Continuation Funds have One. Borrowing: Most Continuation Funds have a clause allowing short-term borrowing. GP Clawback provision: Most Continuation have this provision.

Source: Paul Hastings (2022) Continuation Vehicles: Six-month snapshot of the key terms of continuation vehicles.

Appendix C: Definition of technical terms and jargon

The following are definitions and descriptions of key technical terms used in this document.

Term	Definition/ Description
Carried Interest	An incentive fee paid to the General Partner by Limited Partners in a private equity fund on delivery of exits and distributions/ returns over above-set performance targets.
Carried Interest Arrangements	An arrangement for splitting carried interest earnings among a GP team.
Clawback Provision	Provisions within a Fund Agreement requiring a General Partner of a Fund to reimburse the Limited Partners of a Fund any carried interest earned over and above carry due to the General Partner once reconciliations are made at the end of the life of a fund and it is determined that the General Partner received excess compensation. This usually applies in instances where carried interest is distributed on a deal by deal basis.
Continuation Fund	An Annexe Fund to an existing [Legacy] Fund, set as a special purpose vehicle, to facilitate the sale and transfer of **trophy assets** from a Legacy Fund to the special purpose vehicle, such that the GP, who manages both the Legacy Fund and the special purpose vehicle, can have continued exposure to the assets transferred. (See '**Legacy Fund**' and '**Trophy Assets**').
Crystallised Carried Interest	A General Partners' **locked-in (earned)** carried interest by virtue of delivering exits and distributions/ returns to Limited Partners of a private equity fund over above set performance targets/hurdle. (See '**Carried Interest'** and '**Hurdle**').
Denominator effect	A situation where Limited Partners are over-allocated to the private equity asset class, over and above their target percentage allocation thresholds prescribed in their investment policies- usually due to poor-performing public market assets.
Disclosure memorandum	Also known as a **'Private Placement Memorandum'**- a legal disclosure document used in fundraising for a private equity fund.
DPI- Distributed to Paid-In Capital	A measure of a private equity Fund's performance, representing the value of the Fund relative to General Partners' distributions to Limited Partners to date.
Final bids	An Offer submitted by prospective investors/ Limited Partners into a private equity Fund to a General Partner in fundraising for the Fund, stating the Limited Partner's terms for the transaction.
Hurdle	Also known as '**Preferred Return**' or '**Required Rate of Return**', the minimum return a Fund is expected to achieve for investors into a Fund, over and above which the GP would then be entitled to receiving Carried Interest. (See '**Carried Interest'** and "**Crystallised Carried Interest'**).
Investor data room	A virtual file/folder containing all relevant documentation related to a private equity fund availed to Prospective Investors/ Limited Partners into a Fund to enable them to carry out their transaction due diligence processes as part of a pre-investment analysis and decision-making process.

Term	Definition/ Description
Key Person Provisions	Provisions within a Fund Agreement barring a General Partner of a Fund from making new investments in the event that one or more named principals of the General Partner's team shall foreseeably be unable to dedicate a pre-specified amount of time to managing the Fund and the portfolio companies invested in.
Legacy Fund	An existing fund nearing the end of its ten or fifteen-year fixed-term life, namely, at the tail end of fixed-term life. This will be a fund in year 7 of a ten-year closed-ended Fund or year 12 of a fifteen-year closed-ended Fund.
LP Advisory Committee	A Committee made up of members of the LP base of a Fund to play an advisory role while providing oversight over the activities of a GP of a fund they are invested in.
Management Fee	Annual fee charged to LPs by GPs for the management of a private equity fund, usually charged as a percentage of capital committed into the Fund, to support overhead costs related to running and operating the Fund, including but not limited to fund" staff costs" origination and due diligence costs, and on-going costs related to managing interests of companies held on the Fund's Portfolio.
No-Fault Removal Provisions	Provisions within a Fund Agreement granting Limited Partners into a Fund the option to terminate the services of a General Partner of the Fund on the grounds of loss of confidence in the General Partner's abilities to generate returns, with action usually triggered " if the value of the fund drops below a certain pre-established threshold – without fault of the General Partner[91]. This is typically invoked when over 75% of Limited Partners vote to terminate the services of the Fund's General Partner.
Private Placement Memorandum	(See '**Disclosure Memorandum**')
Private Placement Subscription Agreement	(See '**Subscription Agreement**)
Removal for cause provisions	Provisions within a Fund Agreement granting Limited Partners into a fund the option to terminate the services of a General Partner of the Fund on grounds of wrongdoing or misconduct. Potential grounds for removal for cause as prescribed in the Fund Agreement may include illegal activities, bad faith actions, wilful default or gross negligence[92].
Rolling LPs	In a GP-led secondaries transaction, Limited Partners of an existing [Legacy] Fund electing to re-invest their interests in a Legacy Fund into a newly formed Continuation Fund. This is on the sale and transfer of assets from a Legacy Fund into a Continuation Fund and subsequent pro rata distributions to LPs of an existing [Legacy] Fund as arising from the asset sale. (See '**Legacy Fund**', '**Continuation Fund**' and '**Selling LPs**').
Selling LPs	In a GP-led secondaries transaction, Limited Partners of an existing [Legacy] Fund electing to cash out their interests in a Legacy Fund. This is on sale and transfer of assets from a Legacy Fund into a Continuation Fund and subsequent pro rata distributions to LPs of an existing [Legacy] Fund as arising from the asset sale. (See '**Legacy Fund**', '**Continuation Fund**' and '**Rolling LPs**').

[91] Dentons (2020), COVID-19 and the general partner removal. Dentons
[92] Dentons (2020), COVID-19 and the general partner removal. Dentons

Term	Definition/ Description
Short-form term sheet	A summarised version of a term sheet (See '**Term Sheet**')
Side Letters	A document stating and outlining the terms of a Limited Partner's investment into a Fund. The General Partner usually prepares this.
Subscription Agreement	An agreement defining the terms of a Limited Partner's investment into a private equity Fund.
Term Sheet	A non-binding agreement setting out the terms and conditions of a Limited Partner's Investment into a Private Equity Fund. This is drafted by the Limited Partner and shared with the General Partner as relates to a prospective investment by the Limited Partner into a Private Equity Fund.
Trophy assets	High-performing assets held on the Portfolio of a private equity fund.
TVPI- Total Value to Paid-In Capital	A measure of a private equity Fund's performance, representing the value of the Fund relative to Limited Partners' paid-in capital to the Fund to date.
Zombie Fund	An Annexe Fund to a [Legacy Fund], set as a special purpose vehicle, to facilitate the sale and transfer of **distressed assets** from a Legacy Fund to the special purpose vehicle, such that the GP, who manages both the Legacy Fund and the special purpose vehicle, can hold assets until such a time that they can either be turned around to be sold at better valuations in future or exited (sold)- in their distressed form- at fair value. (See '**Legacy Fund**').

Appendix D: Useful resources and recommended reading

The following are helpful resources and recommended reading for GPs (and their advisors) considering setting up a Continuation Fund through pursuing a GP-led secondaries transaction.

	Reference and reference hyperlink	Useful for:
1.	International Limited Partners Associatoon-ILPA. (2023). Continuation Funds: Considerations for Limited Partners and General Partners. ILPA	Guiding Principles for executing GP-led secondaries transactions towards setting up a continuation fund.
2.	Kastiel, K., & Nili, Y. (2023). Exhibit A: High-Class Conflicts.	Conflicts of Interest Considerations.
3.	Securities and Exchange Commission (2023). Fact Sheet: Private Fund Proposed Reforms.	Regulatory Considerations.
4.	Paul Hastings. (2022). Continuation Vehicles: Six-month snapshot of the key terms of continuation vehicles. Paul Hastings Secondaries Practice Research. Paul Hastings	Continuation Fund Economics (Fees and Carried Interest) Considerations.
5.	Susgaard-Vigon, M., Docker, D., Selden, D., & Singam, T. (2021). Keeping up with Alternative Investment Funds- 2021 Year in Review, **Page 3-5**. PWC.	Secondaries Transaction Tax Considerations.
6.	Susgaard-Vigon, M., Jain, R., & Selden, D. (2022). Keeping up with Alternative Investment Funds- 2022 Year in Review- , **Page 11-13**. PWC.	
7.	McCarthy, S., & Saigol, L. (2021). Private equity turns to continuation funds to keep hold of trophy assets. Financial News	Secondaries Transaction Case Studies.