

The Evolving Landscape of the Secondary Fund Market

BY: Chris Payne, Managing Director

Historically, LP-led transactions have dominated the secondary fund transaction market. Recently, many GP sponsors have entered this market and represent nearly half of the overall market (see sidebar). This has led to calls for increased price discovery and transparency, with a potential rule coming from the SEC that would require sponsors to obtain a fairness opinion when engaging in GP-led transactions.

What is a GP-led Secondary Market Transaction?

Generally speaking, a GP-led secondary market transaction involves a sponsor-advised fund selling one or more portfolio companies to a newly formed continuation vehicle, or CV. This CV is managed by the same sponsor and generally capitalized by one or more secondary buyers, often institutional LPs. These transactions offer investors in the existing fund their choice of three options: (1) a liquidity option (the opportunity to sell their interest in the underlying assets being transferred), (2) a status-quo option (roll their interest into the CV on the same terms as the existing fund); or (3) re-investment option (re-invest into the CV on new terms negotiated by the lead secondary buyers, often with an additional capital commitment).

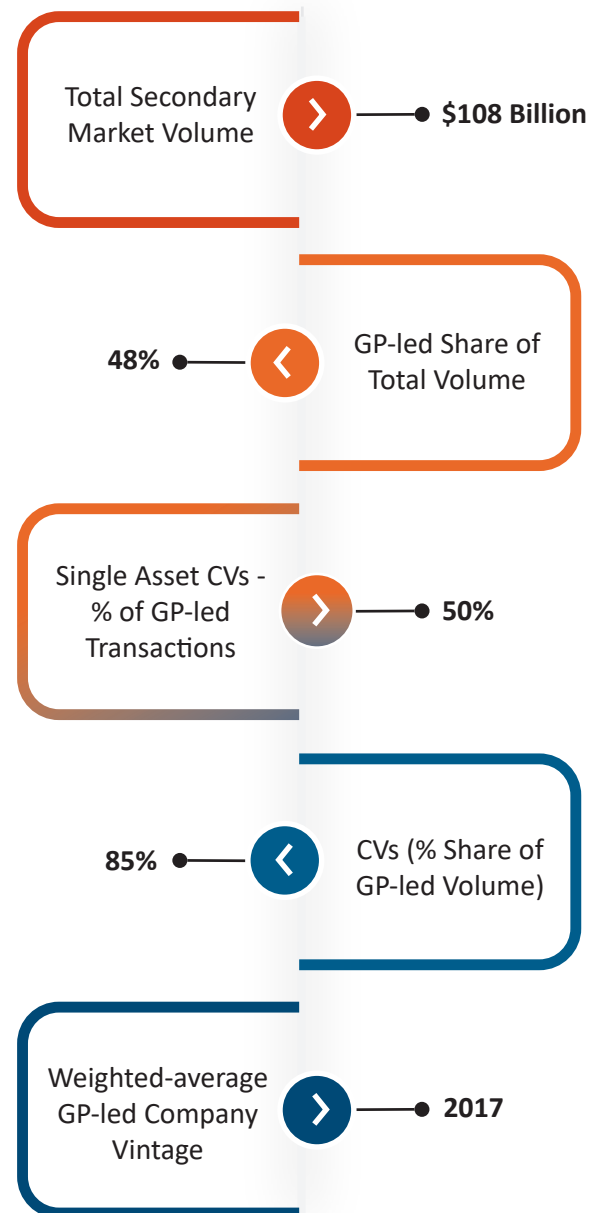
What is driving the growth in this market?

Transferring the assets to a continuation vehicle is attractive to GPs since this allows the sponsor to generate returns from a cash-flowing portfolio company beyond the life of the original fund. Additionally, the transfer to the CV can result in the realization of carried interest for the sponsor. For LPs, these transactions can address liquidity concerns. For example, if an investor is overallocated to private equity, a GP-led secondary can provide liquidity, giving the LP an opportunity to rebalance the portfolio.

The GP-led transaction market has grown significantly over the last several years (see sidebar).

Pricing and Valuation Best Practices

The *Institutional Limited Partners Association* (an LP advocacy group) encourages investors to probe into a sponsor’s rationale for engaging into these transactions. Evidence of price discovery (how the sponsor determined the sale price) is essential to the GP-led secondary process. Additionally, fairness opinions can also provide assurance on price. The Securities and Exchange Commission has recently proposed a rule which would require sponsors in GP-led secondary transactions to obtain a fairness opinion.



The timing of the vote on this proposal being enacted as a rule is yet to be determined; nonetheless, obtaining a fairness opinion for GP-led secondary market transaction remains a best practice and is something all GPs should consider.

The team of trusted advisors at Empire works with dozens of GPs in matters related to acquiring, growing, and monetizing a sponsor's private company investments. We can help simplify the complexities surrounding GP-led secondary market transaction by giving sponsors the assurance needed to alleviate any transaction price concerns through a fairness opinion, which addresses the fairness, from a financial point of view, of a sale of private company assets.

Source: Global Secondary Market Review, Jefferies, January 2023

Empire Valuation Consultants has grown into one of the nation's leading and most respected independent valuation consulting firms, preparing 45,000 valuations and assurance engagements over our 30-year history. Our wealth of valuation experience includes nearly every industry and type of investment (equity, debt, real estate-backed assets, intellectual property and intangible assets), offering clients well-balanced valuations that are specifically tailored to each situation. The success of our refined valuation process is reflected in the firm's reputation in the marketplace. Time and again, asset managers, accountants, attorneys and bankers turn to us for timely, defensible, and comprehensible valuation work.

Chris is a Managing Director at Empire Valuation Consultants, where he has worked for over 15 years.



During this time, he has managed and prepared valuations involving various classes of equity and debt securities and other hard to value assets. He advises clients on matters related, but not limited to, estate and gift tax planning, M&A and SEC reporting. Chris works with private and public companies, high-net-worth families and financial institutions.

Chris specializes in valuing companies in the asset management industry and has worked with firms with assets under management up to \$100 billion. He also oversees assignments integral to the valuation process, such as compiling and analyzing financial data related to capital markets and secondary markets, including hedge funds, PE funds and real estate funds.

Prior to joining Empire, Chris worked at PwC in the real property valuation group, and Rochester Gas & Electric in their treasury department.