

E X P E R T Q & A

Credit secondaries has strong momentum but still room for growth and new players, according to Bruno Bertrand-Delfau, Chris Robinson and Mike Suppappola, partners and co-heads of the Secondary Transactions and Liquidity Solutions practice at Proskauer



Expanding buyer universe fuels growth

Q How would you describe the current market growth and momentum in credit secondaries, and what are the drivers?

Mike Suppappola: The market is expanding at an exponential rate, with exceptional momentum both in terms of deal volume and a growing pool of dedicated buyers.

There are several drivers: first is the growth of the secondaries market. A large number of top-tier credit fund sponsors have taken notice of the expansion opportunity presented by the development of the secondaries market, and many have begun to capitalise on that by presenting new

SPONSOR
PROSKAUER

product lines to meet the demand. This is an expanding segment of global private markets, and traditional credit sponsors bring valuable underwriting experience and seasoned deal execution to the table.

On the other side, experienced secondaries buyers with large Rolodexes of sponsor relationships, many of which are active in both the private equity and credit space, are looking to capture market share by growing or acquiring teams with the requisite credit expertise. That

combination of new players has driven growth.

Chris Robinson: Another driver is the need for liquidity within the private credit primary market. The industry grew substantially between 2019-22, with a lot of funds raised – Proskauer raised more than 200 funds, with more than \$160 billion of commitments during that period alone.

Those funds are now looking to deliver liquidity to LPs, with higher interest rates causing some borrowers to seek extensions of maturity or PIK toggles. At the same time, LPs want liquidity to allocate capital into other funds or adjust allocations.

Bruno Bertrand-Delfau: Since 2021, the private equity market globally has been the subject of a liquidity drought, with distributions falling sharply due to a decrease in exits. That means financings put in place on many private equity deals need to be extended or refinanced, causing liquidity issues not only for equity holders but also for private debt holders.

In this context, innovative liquidity tools put in place to provide liquidity to the private equity market are now being used to make liquidity available to debt owners. For example, continuation vehicles have been adopted very quickly and now represent most of the transactions in the credit secondaries space.

On the investor side, the secondaries asset class has become popular with high-net-worth and retail investors, with evergreen vehicles and semi-liquid vehicles flourishing. A number of them are dedicated to credit secondaries or invest in a mix of direct lending, credit secondaries and other liquidity solutions, creating further buy-side dry powder.

Q What is attracting new buyers into the market, and what are those buyers looking for?

BB-D: For a long time, the market did not warrant the interest of a lot of players because it was very limited in volume. It is debt, not equity, so to make it work you need large volumes. Activity has really picked up in the past two years, attracting the interest of a lot more players.

MS: When we first started doing credit secondaries about 10 years ago, traditional private equity secondaries managers were generally attempting to jump into executing credit secondaries through products featuring private equity secondary return targets. But the return profile for credit is often lower than you would typically target with those products, so there was a

“There is a huge primary asset base of several trillion that has been increasing as the banks retrench”

BRUNO BERTRAND-DELFAU

natural limitation on the number of credit-focused portfolios you could fit into that type of strategy.

Secondary buyers and credit funds have since taken advantage of the opportunity to form products around target returns specific to credit. There are still a small number of buyers trying to repurpose private equity secondaries frameworks into credit from a deal execution and pricing standpoint, but they are now competing with buyers that really understand the nuances of credit. It requires a different category of underwriting.

CR: The private equity secondaries market was long dominated by the same few very large firms. Now we see new entrants including specialists and spin-offs from larger players, which is healthy. In addition, through the sharp growth of continuation vehicles, we have seen direct private equity players looking at single-asset strategies for continuation vehicles.

We now expect the same in credit, with generalist large secondaries funds entering the market when volumes are sufficient, along with more specialists and more direct lenders creating credit secondaries arms.

Q GP-led transactions now represent most of the transaction volume in credit secondaries. Why is that, and what do those deals look like?

BB-D: We are seeing multibillion-dollar transactions in the US and Europe – both global volume and transaction size have risen sharply.

On the sponsor side, the drivers of those transactions are providing liquidity to their LPs, resetting carried interest, extending the holding period of loan portfolios or securing new money for follow-ons.

CR: On the investor side, there is also the realisation that credit secondaries allow you to reduce the J-curve in funds because you are immediately committed. That means your money is at work and you can anticipate quicker returns. Plus, what you are investing into is a known portfolio, and you can do due diligence to assess its risk profile.

Secondaries has a lot of advantages well known to private equity secondaries investors, and now that opportunity is opening up on the credit side.

Q With increasing dealflow and broader market participation, is undercapitalisation still an issue in credit secondaries?

BB-D: There are more deals on the table than buyers can look at, so the market does appear undercapitalised.

MS: Certainly the market could grow at a much faster rate if there were more buyers, but notwithstanding all the recent new entrants, there is still not nearly enough credit secondaries talent to keep up with the potential dealflow. Sustained market growth will require a substantial influx of credit capital that can underwrite and analyse credit-specific assets – not just senior loans but also more complex structures. That is still emerging.

Secondaries

That dynamic preserves the undercapitalisation problem because some of the deals that need the most liquidity are the most difficult to underwrite. Even the private equity secondaries market is undercapitalised, and I cannot foresee a situation in five years' time where we say it is fully capitalised.

CR: We are seeing \$3 billion-plus transactions coming to market and there are less than a handful of players able to underwrite those deals. For the market to be more competitive and dynamic, we do need more of those players and they need bigger funds.

Q How are BDCs and semi-liquid products influencing the market?

BB-D: The effect of the recent multiplication of redemption gate closing on private debt funds is hard to assess, as it is very new. We have not yet seen secondaries transactions driven by that. However, it appears that the impacted credit fund managers will not have many other options to access liquidity other than selling, and when you sell private credit, it becomes a credit secondary.

MS: BDCs and interval funds have created a new category of liquidity events. They will become sellers when they need to, regardless of where we are in the cycle. A lot of secondaries buyers are building great relationships with BDC teams and learning to understand those structures, so we expect to see future dealflow come from that.

Q How do you see the market developing, and what are your predictions for credit secondaries over the next few years?

MS: Increased dealflow is certainly going to continue as more credit funds seek liquidity solutions and the private credit buy-side market keeps growing. A continued need for liquidity solutions in the credit space will bring more buyers

Q How have you seen credit secondaries strategies expanding beyond traditional senior debt?

MS: The market has certainly started to evolve from a narrow focus on senior direct lending towards a much broader and more diversified opportunity set. Pricing complexity increases dramatically as you move down the capital structure and the secondaries market is just starting to price that in.

A lot of the first movers in credit secondaries were focused on senior debt, which is relatively easy to price versus other areas of credit, and the maturities were a bit more condensed. Now, as we move into mezzanine and preferred equity in the secondaries context, that requires modelling of things like call protection, PIK accruals and intercreditor arrangements. You have to dig deep on the different aspects of the underlying portfolios.

CR: In continuation vehicles, we often see a mix of different types of debt, from senior to subordinated and preferred. The difference from private equity is that single-asset continuation vehicles do not make sense in credit. The dynamic is different, with private equity GPs often wanting to stick with star assets and manage them to maturity. In the debt world, you do not see that.



to market. Between our private credit fund formation, secondaries and direct transactional practices, Proskauer is deeply involved in each segment of the private credit universe, so we feel we have a unique vantage point to see where the market is heading.

CR: That view allows us to identify trends early and navigate complex deal structures. We expect the industry to grow to between \$50 billion and \$80 billion by the end of the decade. While the great financial crisis proved a key stress test for private equity, we have yet to see the first major default cycle in private credit.

When that happens, it will be disruptive but it could also be a growth

driver, so it will be interesting to see what develops through the cycles.

BB-D: Credit secondaries are fairly new but we expect adoption to grow and the market to want more liquidity solutions. On the sellside, there is a huge primary asset base of several trillion that has been increasing as the banks retrench, and on the buy-side, we anticipate investor interest in secondaries to continue to grow. Altogether, that should be a recipe for success. A lot of the technology from the private equity secondaries space is now transferring into credit, so our long-standing leadership in the market positions us to support clients in this exciting growth period for credit secondaries. ■