

Agenda

8:30am **Welcome and Registration**

9:00am **Opening Remarks**

Overview of GP led transactions

Continuation Funds: Rationale, Pros & Cons

Stakeholders and Key Risks

Economic Terminology and Concepts

10:30–10:45am **Coffee Break**

Structuring Continuation Funds

Process and Documentation

Key Fund Terms & Considerations

Key Transaction Terms & Considerations

12:00pm **Closing Remarks and Networking Lunch**

As a market leader in secondaries transactions, our team advised on 400+ secondaries transactions that closed with aggregate total deal values exceeding \$60 billion over the past year.

As noted by *Secondaries Investor* in its 2023 survey, “Proskauer Rose provided counsel to the highest number of transactions of all law firms.”

Our market-leading global secondaries team provides in-depth advice on all aspects of the secondaries market. We have counseled a large segment of the secondary market since the dawn of the secondaries industry. Our expertise covers all types of transactions, including GP-led liquidity solutions (including single and multi-asset continuation funds, strip sales and spin

outs), tender offers, direct secondaries transactions, preferred equity deals, and some of the largest bulk purchases and sales of interests in the history of the secondaries market.

Given our vast market knowledge and experience representing GPs, buyers and sellers across all sectors and geographies, the breadth and depth of our practice ensures that we are uniquely positioned to provide our clients with innovative commercial solutions to the most complex transactions in the market.

Event Speakers



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Partner



Lucie J. Rose
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Duncan Evans
Associate



Jack Gladman
Associate



Philip Lenertz
Associate

Secondaries School

First for Market Insights

Proskauer»

Proskauer's Secondaries School: GP-leds & Continuation Funds

22 May 2024

Proskauer»

Welcome



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Agenda – Before the break



Introduction to GP-Led Transactions: The Spectrum of Options



Introduction to Continuation Funds

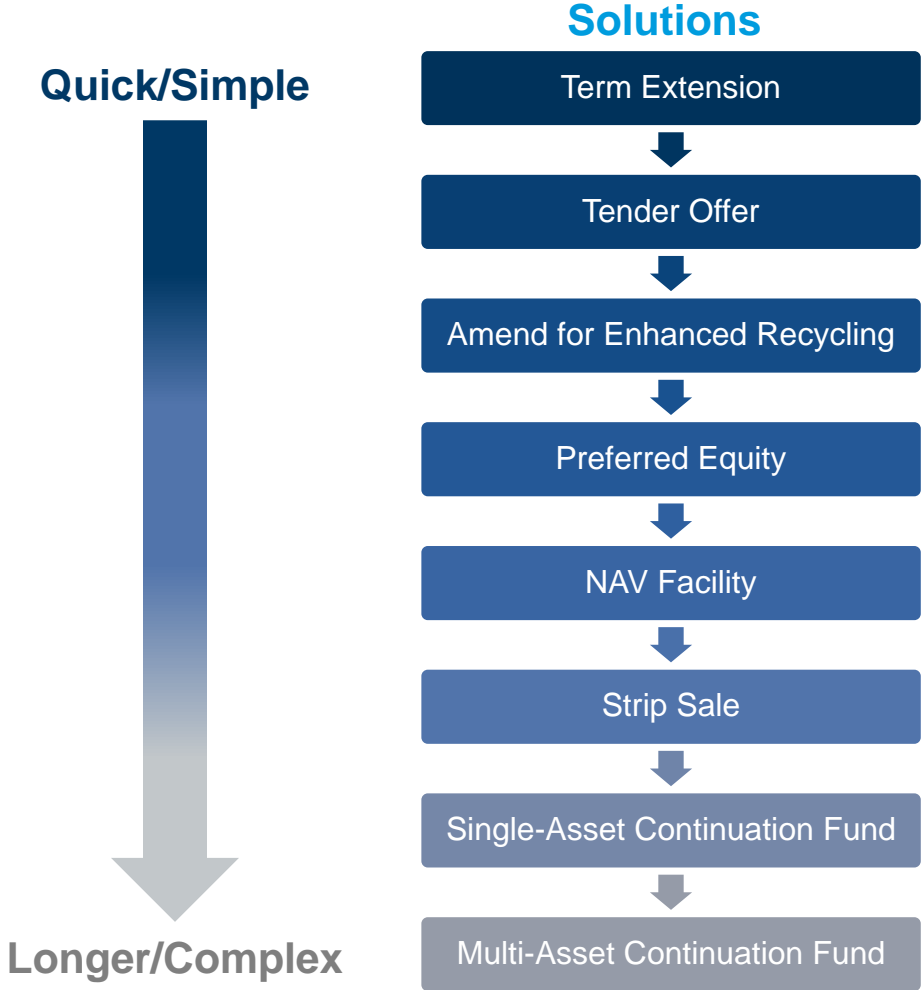


Continuation Fund Stakeholders: Goals & Concerns

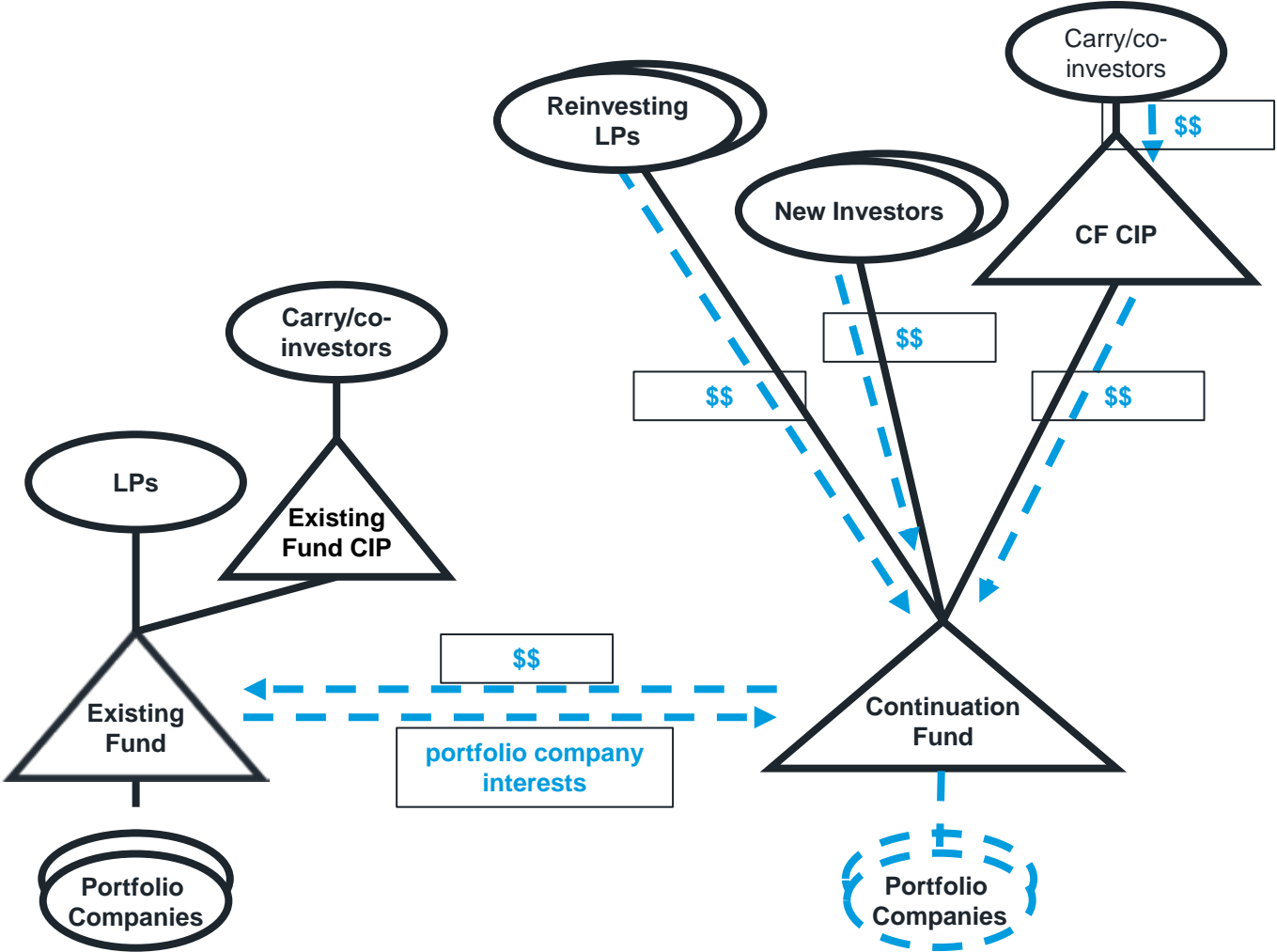


Economic Concepts

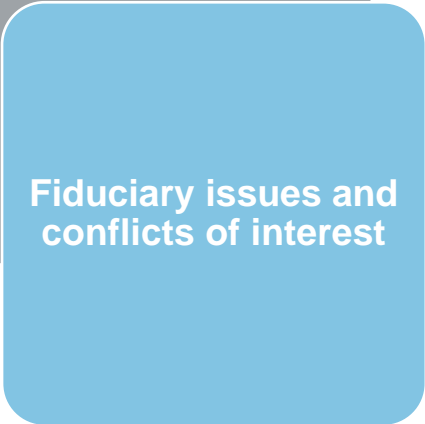
GP-Led Transactions Options at-a-Glance



Continuation Funds: Rationale; Pros & Cons



Key Risks



Fiduciary issues and conflicts of interest



LPAC / LP engagement and consent



Tax structuring and regulatory considerations

Stakeholders

Buyers

Existing LPs

Sponsors

Economic Interests: General Concepts

Crystallized Carry

The value of carried interest as *finally determined* based on a distribution of the target portfolio companies (valued at the negotiated transaction value) by the original fund pursuant to the fund waterfall.

- Selling LPs
 - GP crystallizes carry
- Rolling LPs (new economic deal)
 - GP crystallizes carry
- Status Quo LP
 - ***GP does not crystallize carry***

Economic Impact of Crystallizing Carry: An Example

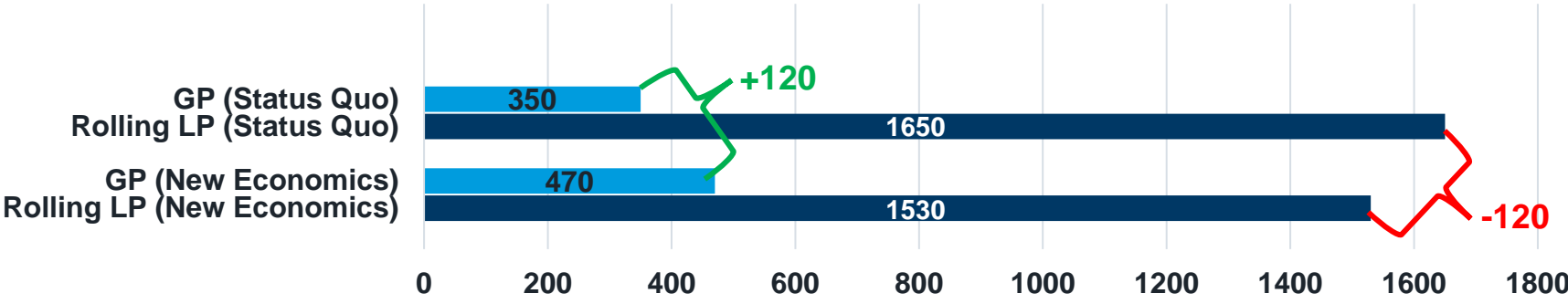
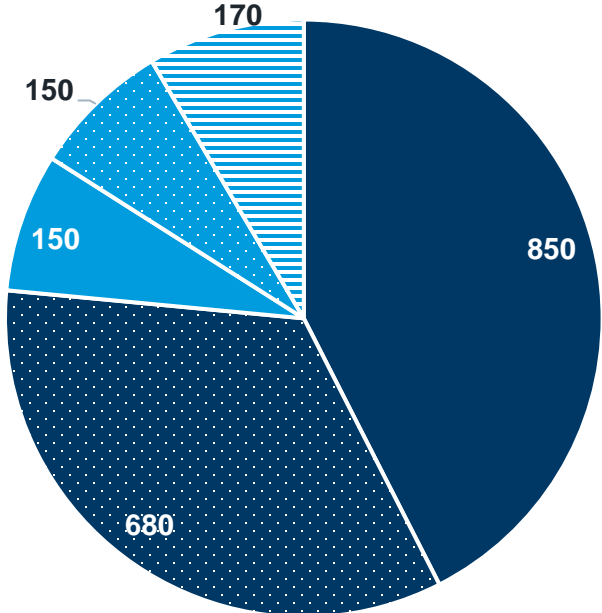
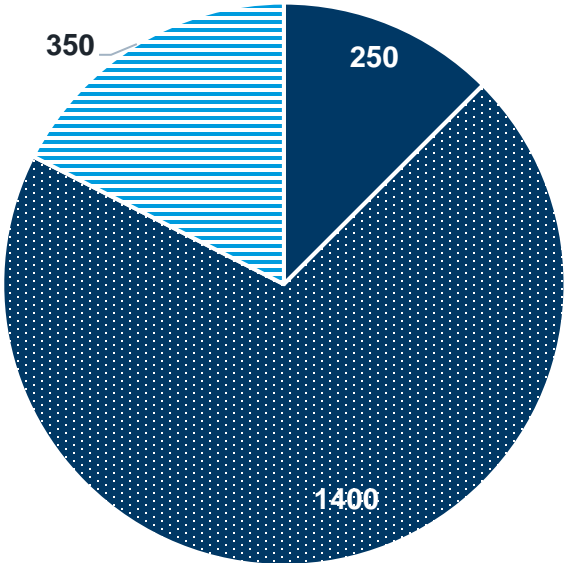
- Cost of target asset = 500
- Continuation fund transaction value = 2000
- Future gain (in CF) = 2000
 - Value of target asset at exit = 4000
- The carry rates for original fund and continuation fund = 20%
 - Assume no IRR/MOIC hurdles to carry
- LP elections: 50% sell & 50% roll

Economic Impact of Crystallizing Carry: Base Case

50% Status Quo Roll

50% Roll Into New Economics

- Rolling LPs
- GP (in respect of Rolling LPs)
- New LP
- GP (in respect of Selling / New LPs)
- Capital/Crystallized Carry
- Return on Capital/CC
- Carried Interest

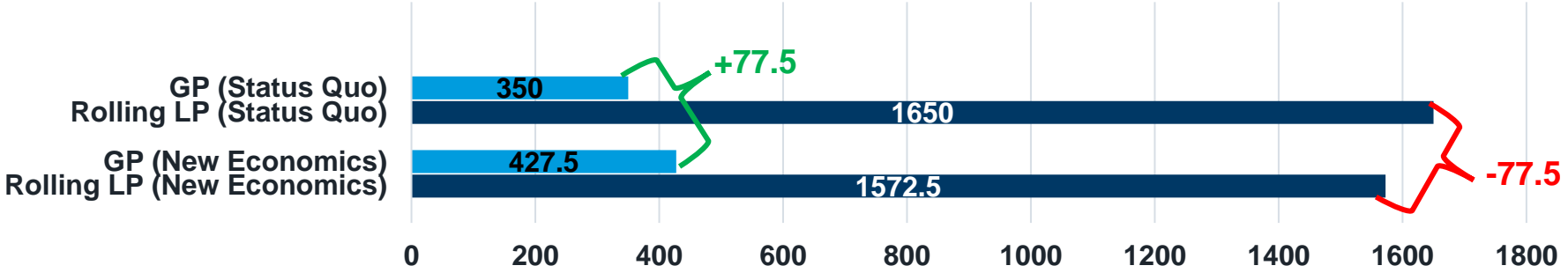
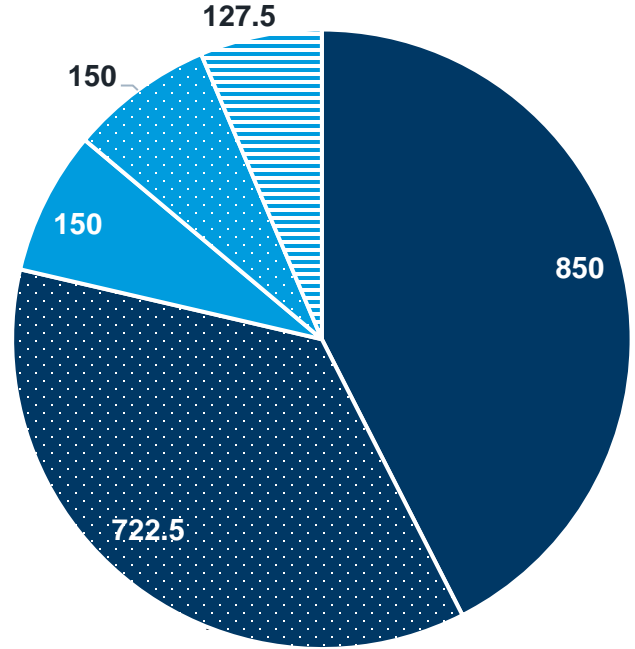
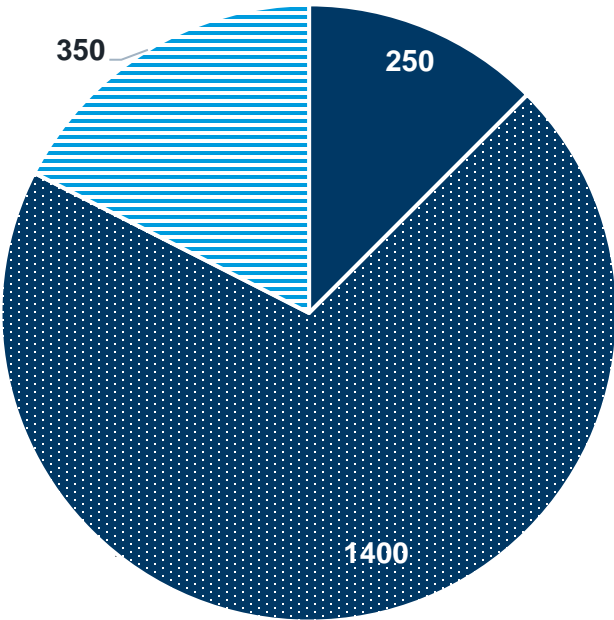


Economic Impact of Crystalizing Carry: Impactful Even When Carry Rate in Continuation Fund is Reduced

50% Status Quo Roll

50% Roll Into New Economics

- Rolling LPs
- GP (in respect of Rolling LPs)
- New LP
- GP (in respect of Selling / New LPs)
- Capital/Crystallized Carry
- Return on Capital/CC
- Carried Interest



Questions and Coffee Break

After the break:

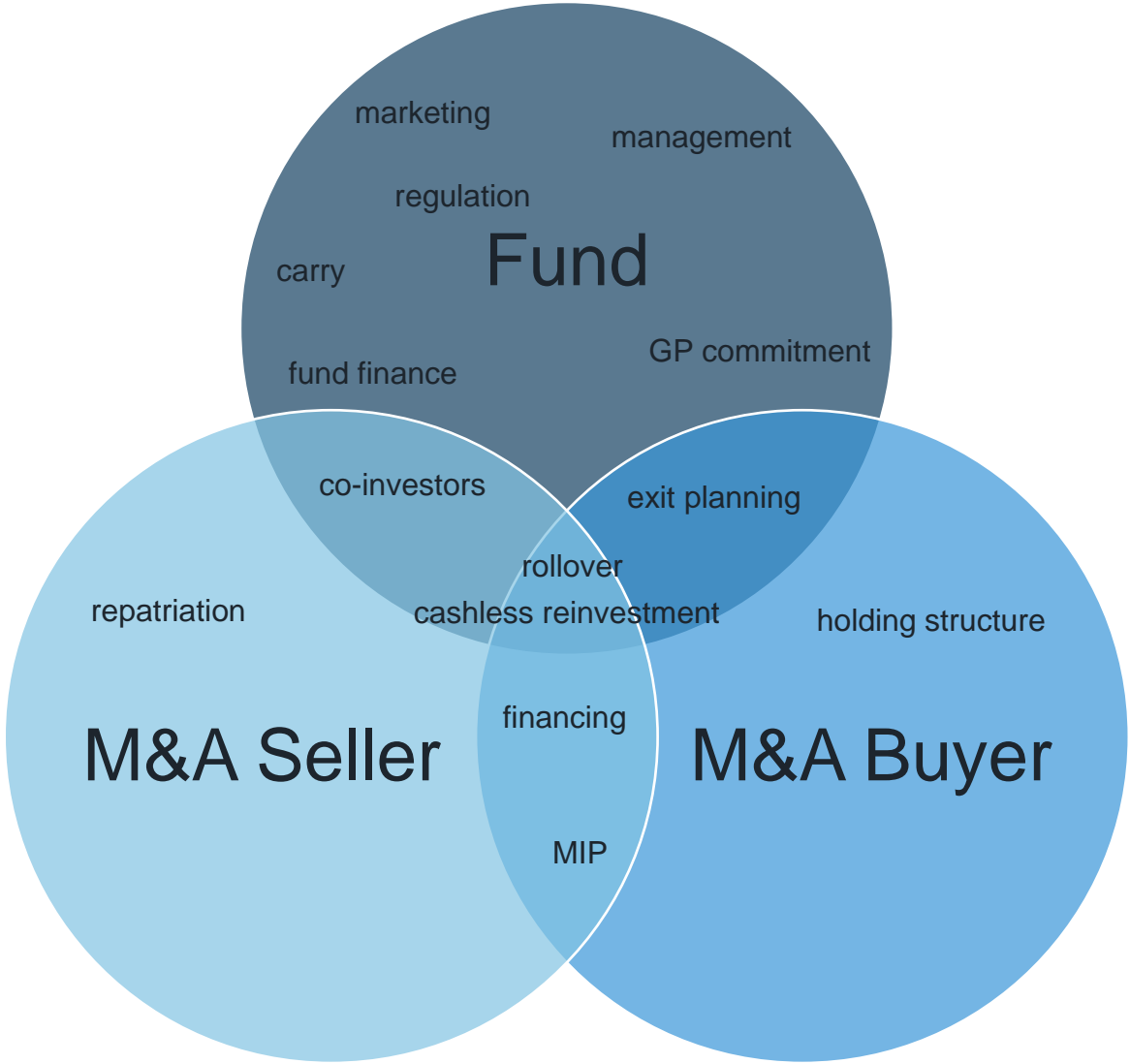
Structuring Continuation Funds

Process & Documentation

Key Fund Terms & Considerations

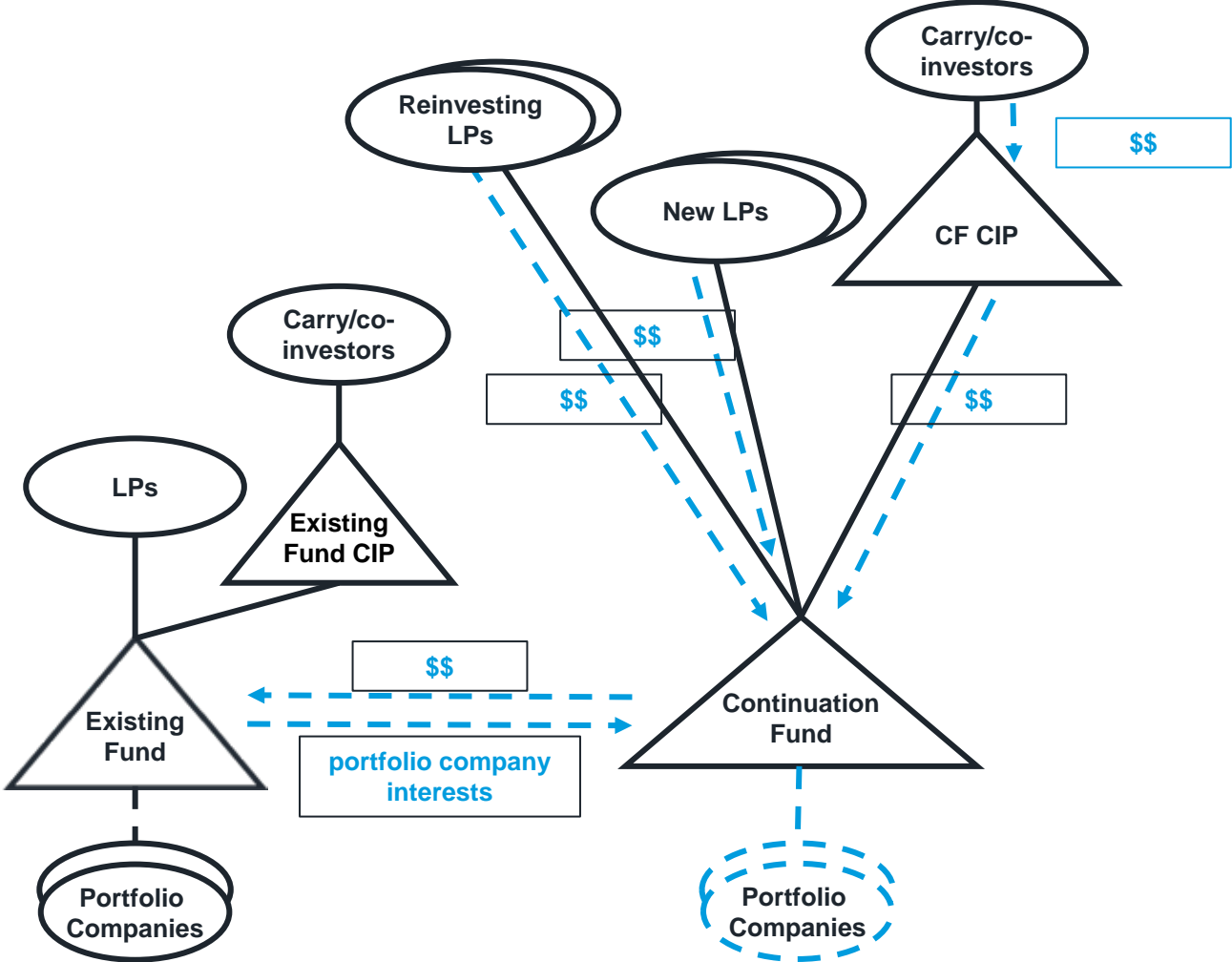
Key Transaction Terms & Considerations

Structuring Continuation Funds

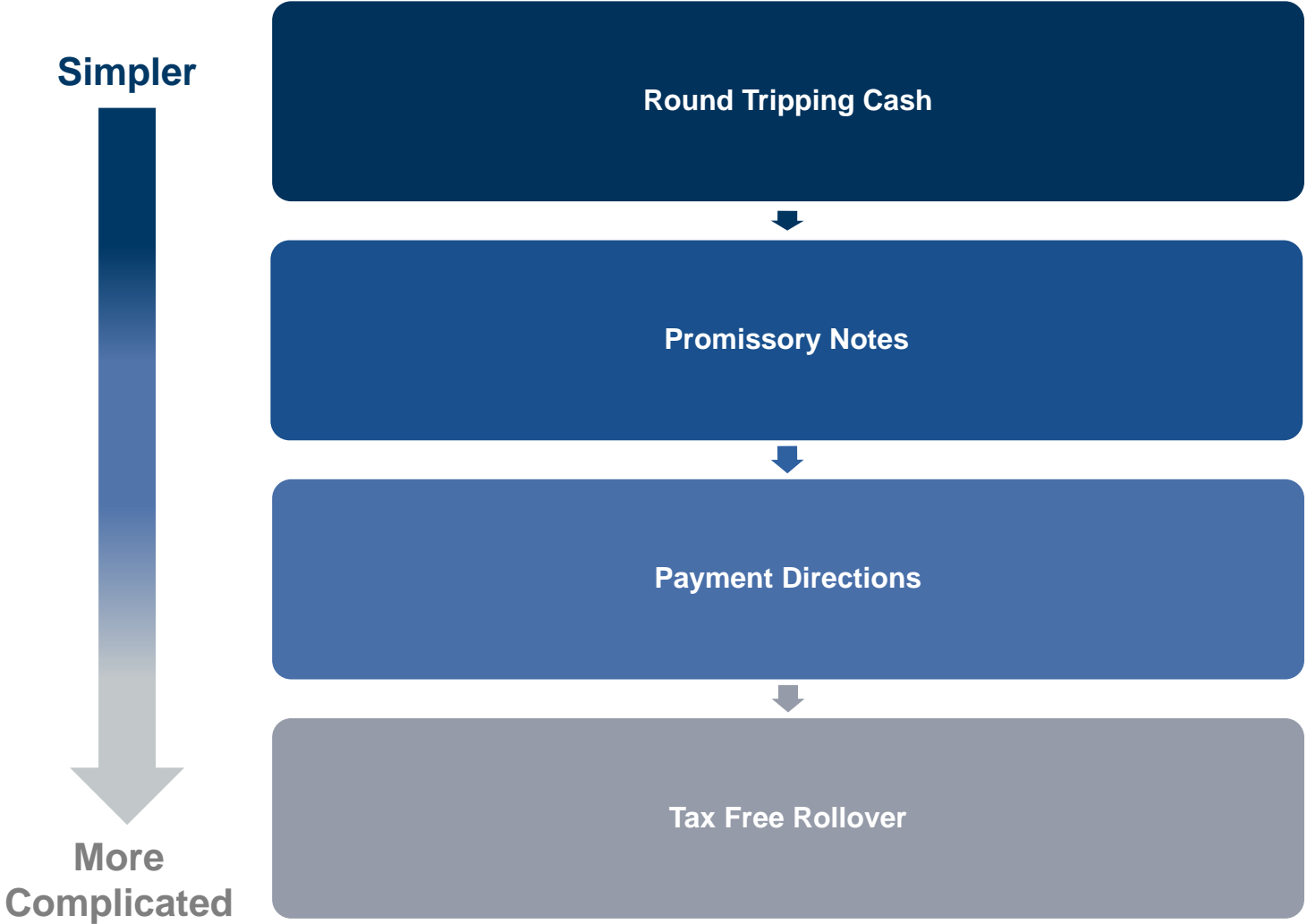


Cash Sale Structure

- **Pros**
 - Simplicity.
 - Taxable to investors.
- **Cons**
 - Taxable to investors.
 - Cashflow issues for reinvesting LPs.

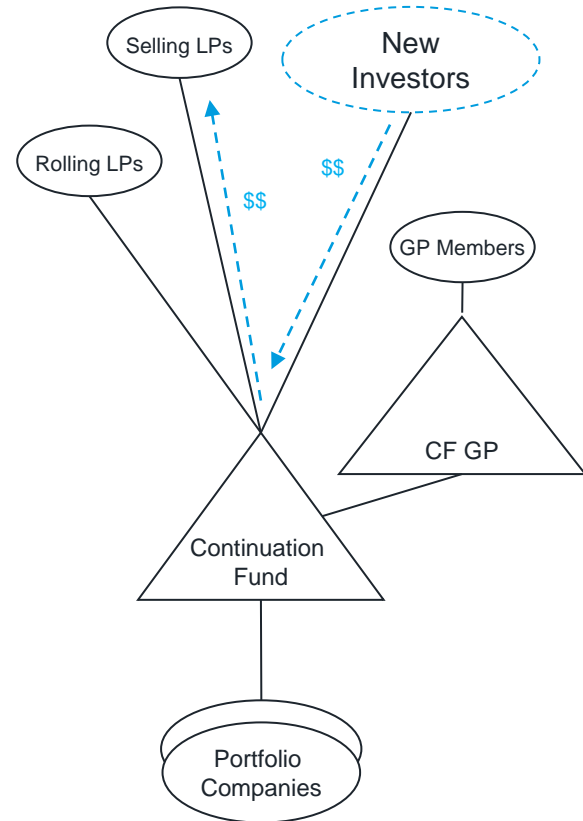
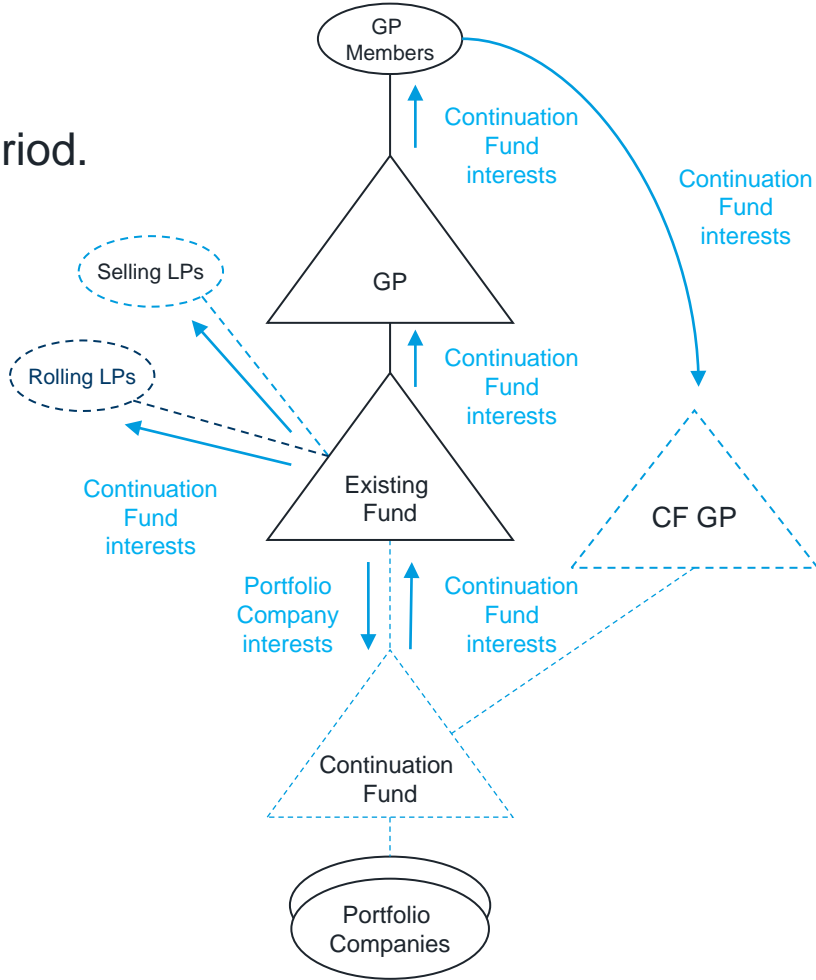


Reinvestment Options



U.S. Tax-Free Rollover

- **Pros**
 - Tax-free rollover.
 - Tacked holding period.
- **Cons**
 - Complexity.
 - Withholding tax considerations.

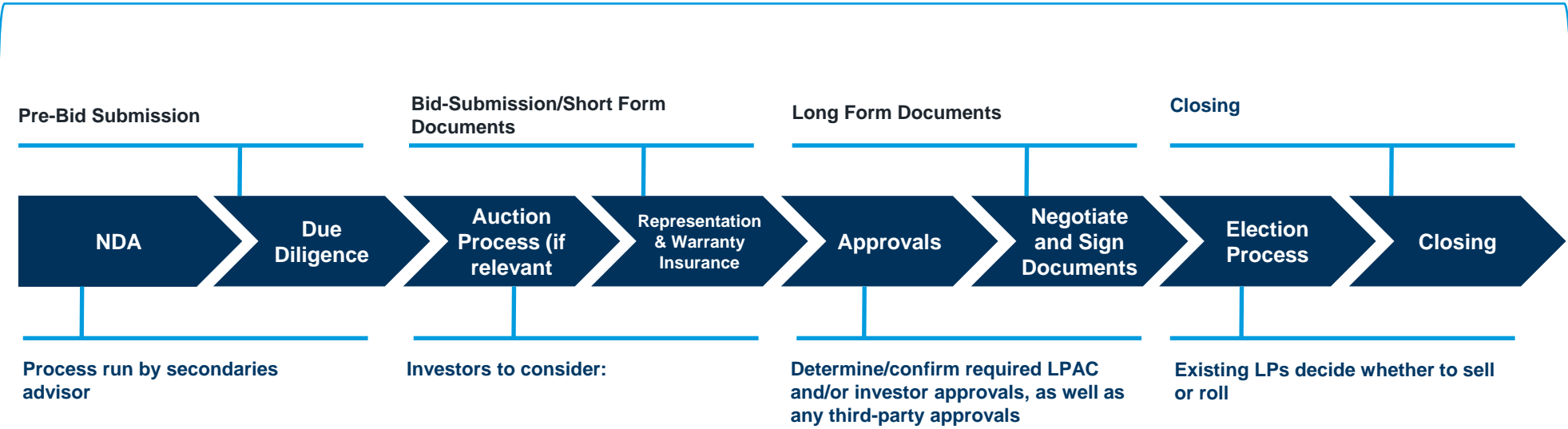


How U.S. Blockers Can Impact Economics

- Corporate tax on sale of target assets out of the blocker.
 - Up to 44.7% tax drag (based on current tax rates).
- Magnitude of unrealized gain in the blocker.
- Size of blocked interest being acquired relative to total transaction value.
- Ability of new investors to make future investments/follow-on investments unblocked.
- Blocker sale covenants.
- Where the sponsor takes its new carried interest pre- and post-transaction.
 - Above the blocker (i.e., net of any applicable blocker taxes)?
 - Below the blocker?
- Purchase price discount?

Indicative Timeline: Continuation Fund

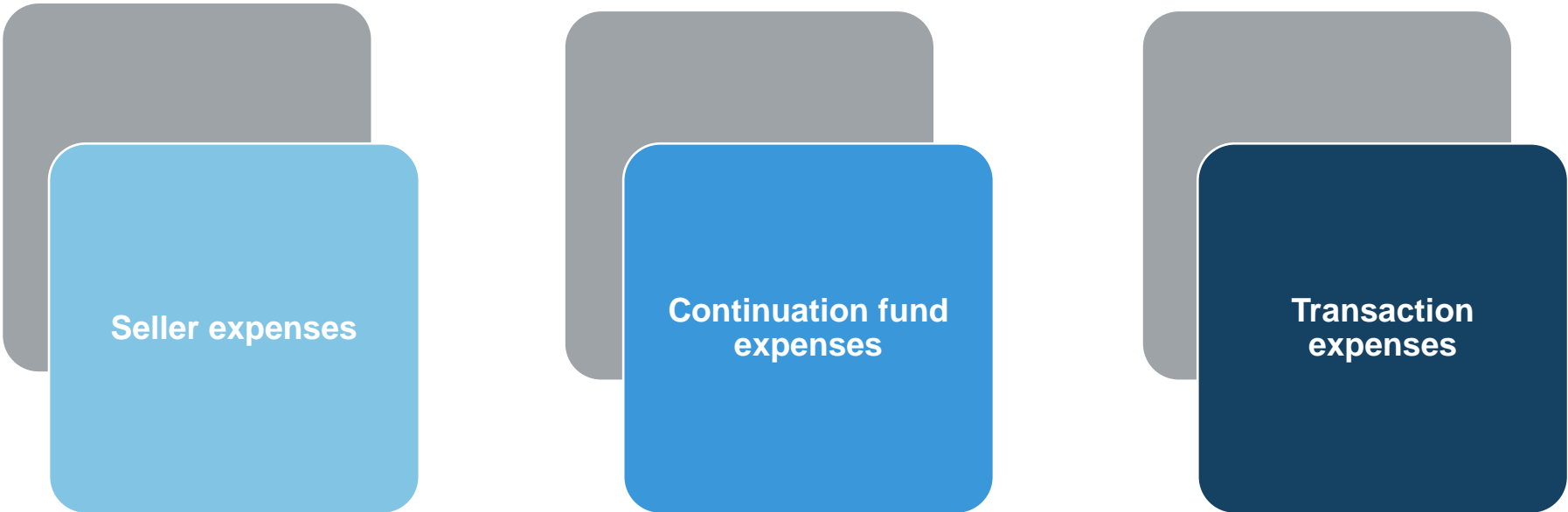
Typically 3-6 months (for buy side)



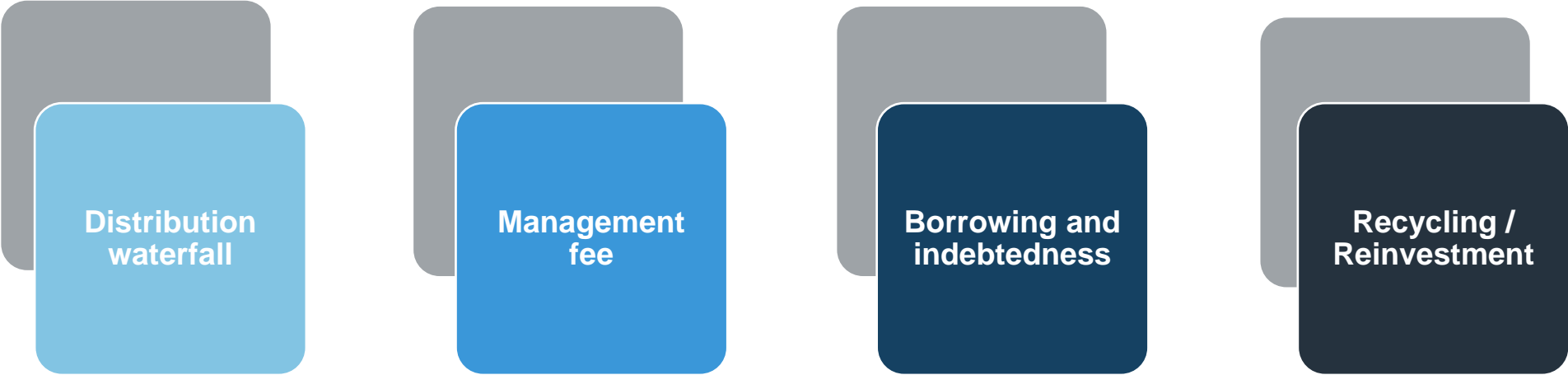
Key Fund Terms – Commitments



Key Fund Terms – Expense Sharing



Key Fund Terms – Economics



Continuation Funds – Dilution & Governance



Questions?

Key Transaction Terms & Considerations

Key Transaction Terms – Sources of Recovery and Limitations

CONSIDERATION

COMMENTS

Source of Recovery

- Warranty & Indemnity Insurance
- Holdbacks

Limitations of Liability

- Non-Fundamental Warranties: Tipping Basket v. Deductible
 - Non-Fundamental Warranties: Cap and Survival Period
 - Fundamental Warranties: Cap and Survival Period
 - Excluded Obligations
 - Fraud
-

Key Transaction Terms – Warranties and Excluded Obligations

CONSIDERATION

COMMENTS

Scope of Warranty Coverage

- Fundamental Warranties
- Non-Fundamental Warranties
- Disclosure

Definition of “Knowledge Parties”

- Identity of Individuals

Excluded Obligations

- Excluded Obligations
 - Excluded Tax Liabilities
-

Key Transaction Terms – Closing Conditions and Tax Covenants

CONSIDERATION

COMMENTS

Customary Closing Conditions

- **Customary Examples of Closing Conditions:**
 - Expiry of election period and receipt of required level of financial commitment
 - Receipt of all anti-trust/regulatory approvals
 - Approval of limited partners
 - No laws prohibiting the transaction
 - Fundamental warranties being true as at signing and closing, and no material breach of non-fundamental warranties
 - Receipt of W&I policy
 - No event of default under any group financing arrangements

Tax Covenants

- 754 election (if applicable)
- Push-out election for pre-closing partnership tax liabilities imposed on audit (if applicable)

Questions?

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Secondaries School

First for Market Insights



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Navigating Liquidity: Proskauer's Secondaries Pulse Check

Executive Summary

Proskauer's Secondaries Pulse Check data benchmarks a variety of secondaries transaction terms, including key legal, economic and governance provisions, across 55 traditional LP and 17 GP-led secondaries transactions. The data covers transactions closed between the third quarter of 2022 and the first quarter of 2023, and provides insight into how terms are changing over time and the market shifts we anticipate moving forward.

The analysis and related commentary reflects our experience from representing sponsor, buy-side, and sell-side clients, providing a unique insight into the market from all angles.

Built to serve asset managers, Proskauer's Private Funds Group will continue to monitor the evolution of the secondaries market, offering our clients insights to aid their transactional and fundraising needs.

Proskauer» For Success. For Progress. For Good.

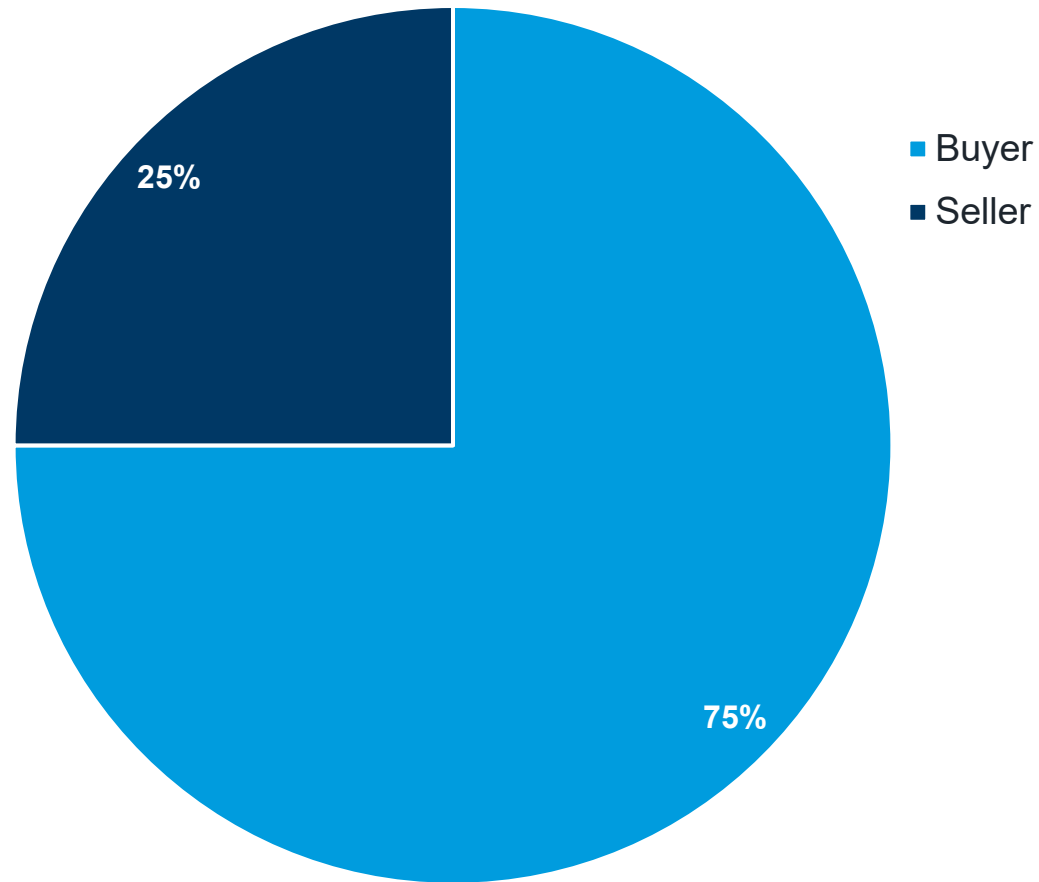
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- 64** Proskauer Articles

Data Insights: Traditional LP Secondaries Transactions

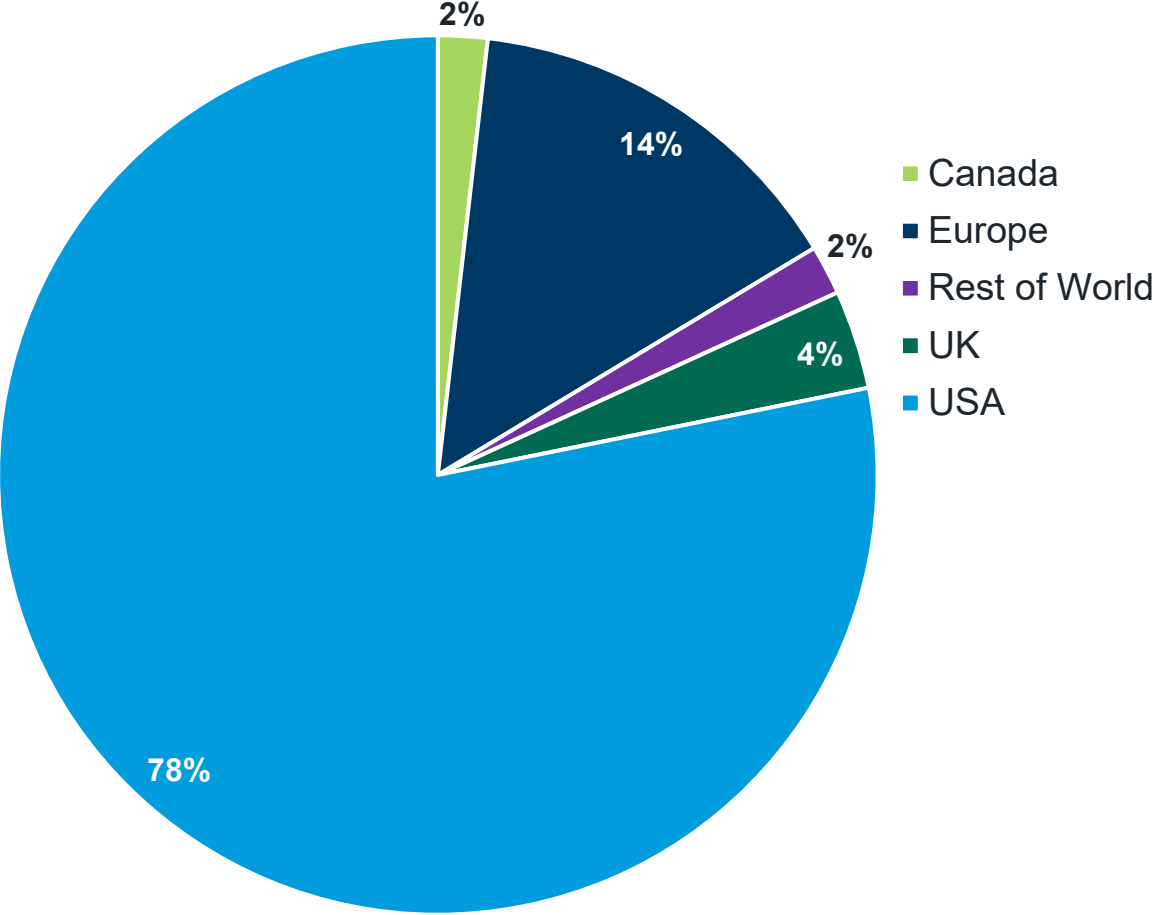
Party Represented

On the 55 traditional secondaries transactions we closed between September of 2022 and March of 2023, we acted on the buy-side on 75% of occasions and acted on the sell-side for the remaining 25% of deals.



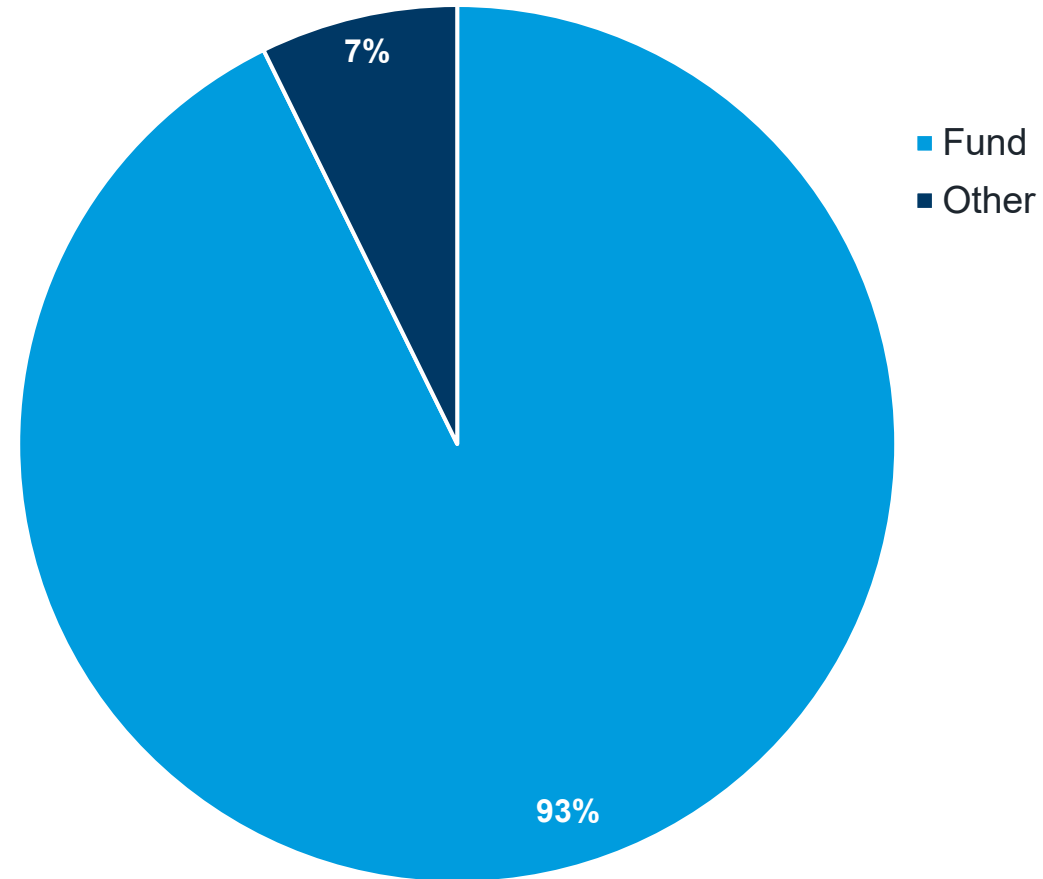
Buyer Legal Jurisdiction

This chart highlights the principal jurisdiction of the buyers, with the largest representations being the USA (78%) and Europe (14%). We saw smaller percentages of buyers based in the UK, Canada and other parts of the world, including Asia.



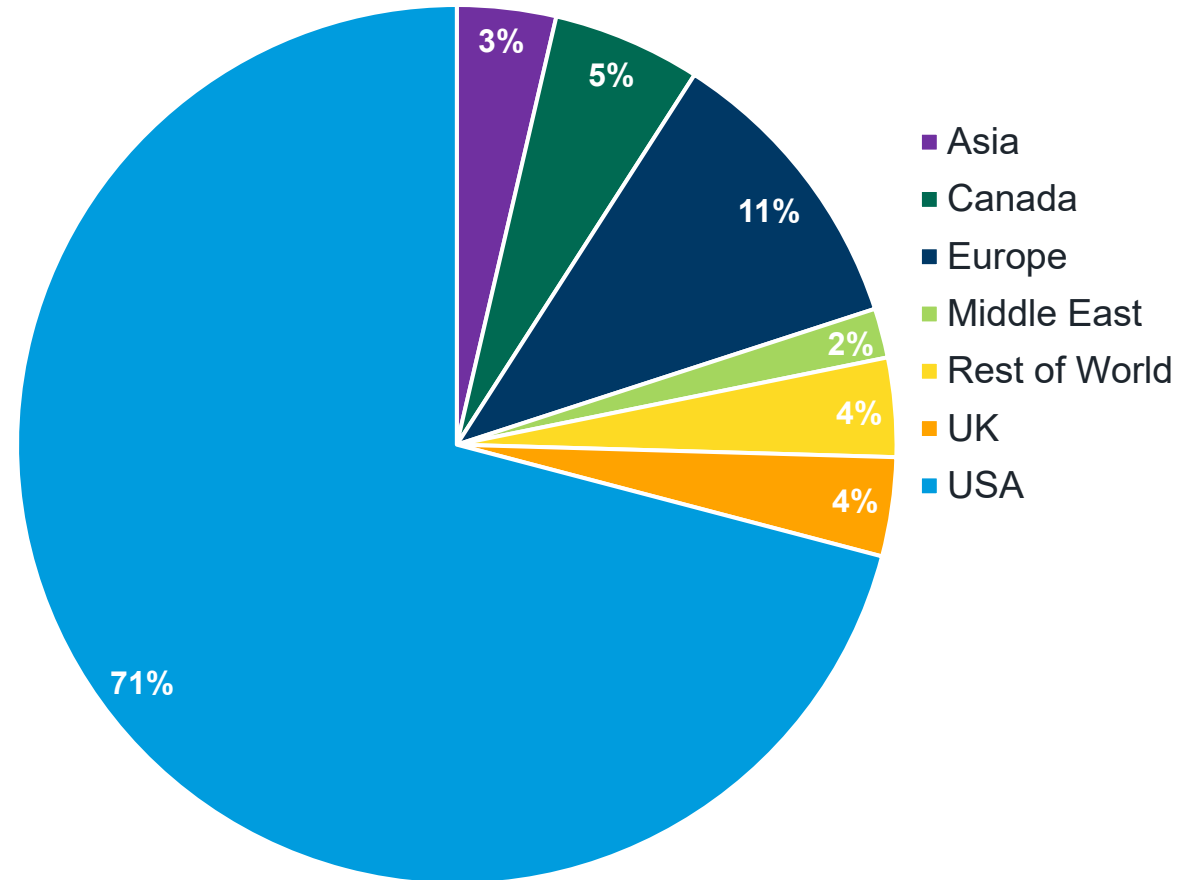
Buyer Type

Unsurprisingly, 93% of the traditional deals we worked on involved a secondaries fund as the purchaser.



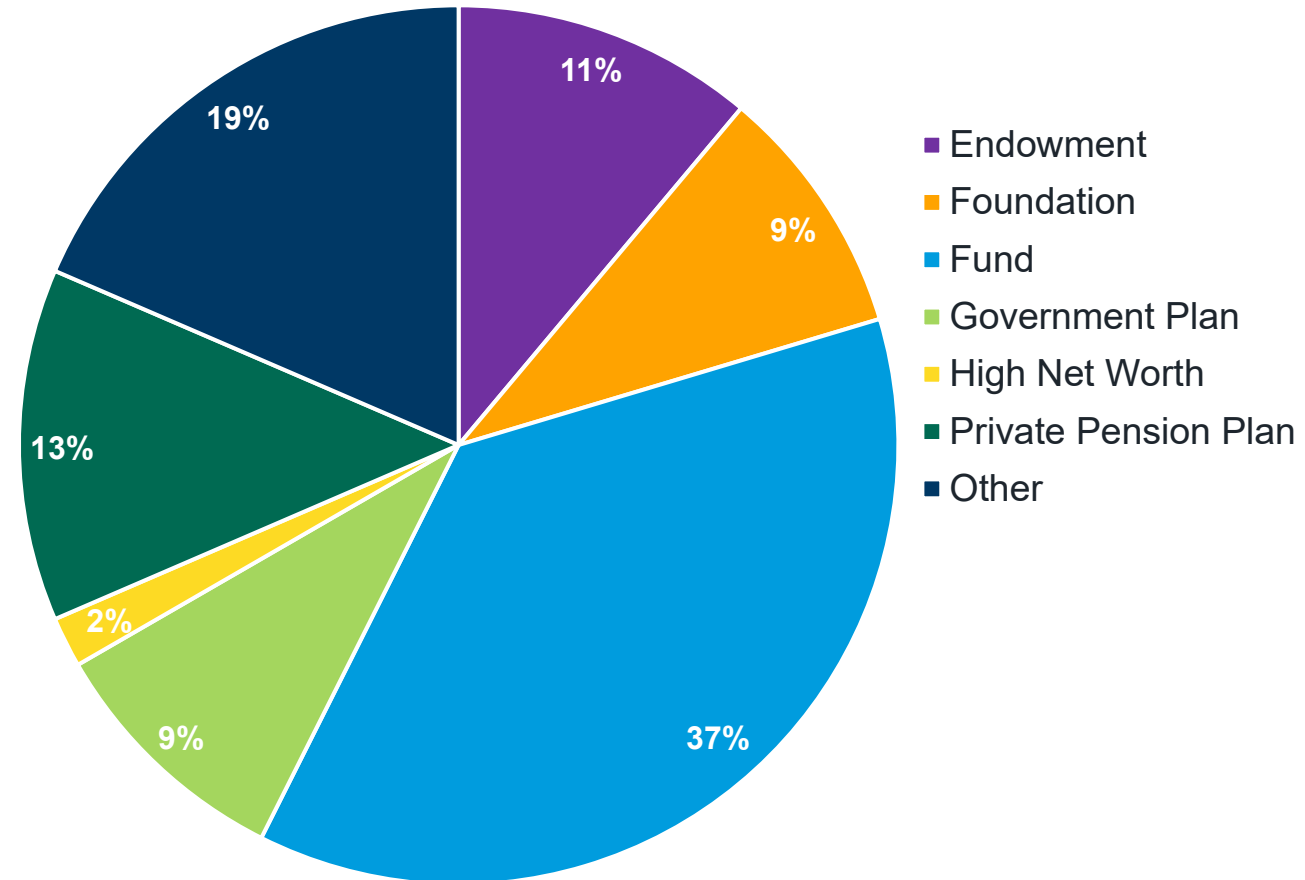
Seller Legal Jurisdiction

Consistent with prior years, a significant 71% of sellers were based in the USA, which was followed by 11% of sellers in Europe, 5% in Canada, and we also saw 4% of sellers based in the UK and 3% in Asia.

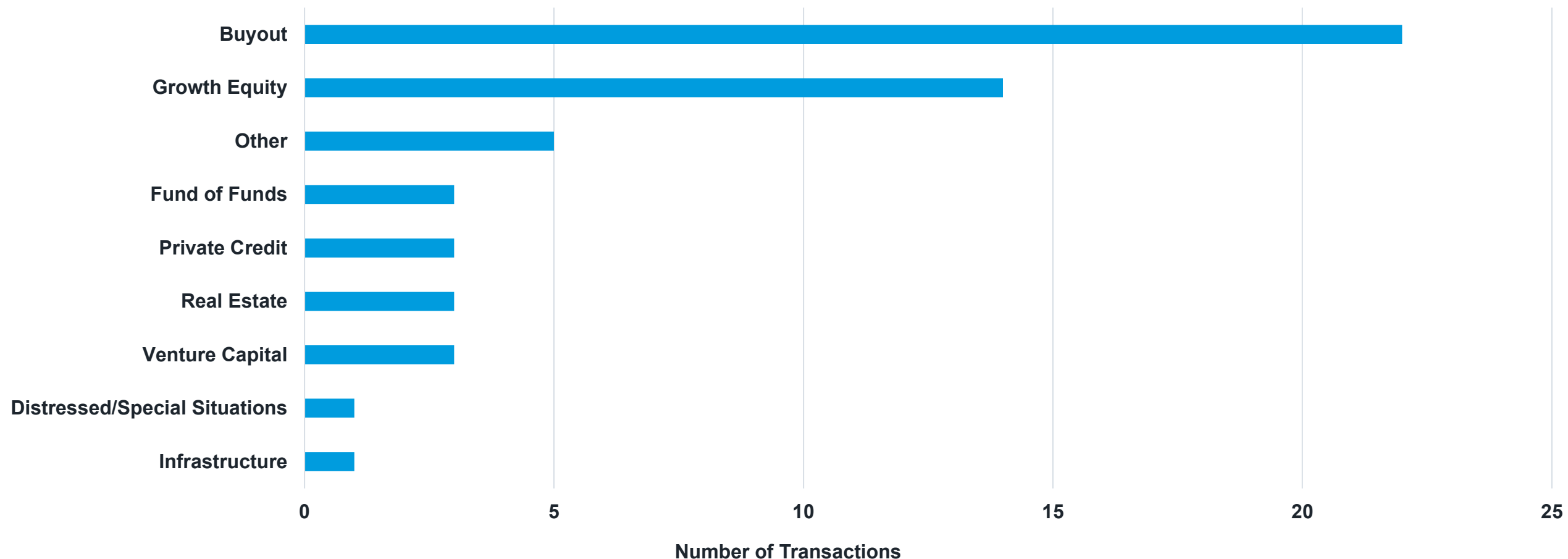


Seller Type

This chart illustrates a relatively broad mix of sellers participating in traditional deals over the past three quarters with secondaries funds (37%), private pension plans (13%) and endowments (11%) being the principal players.

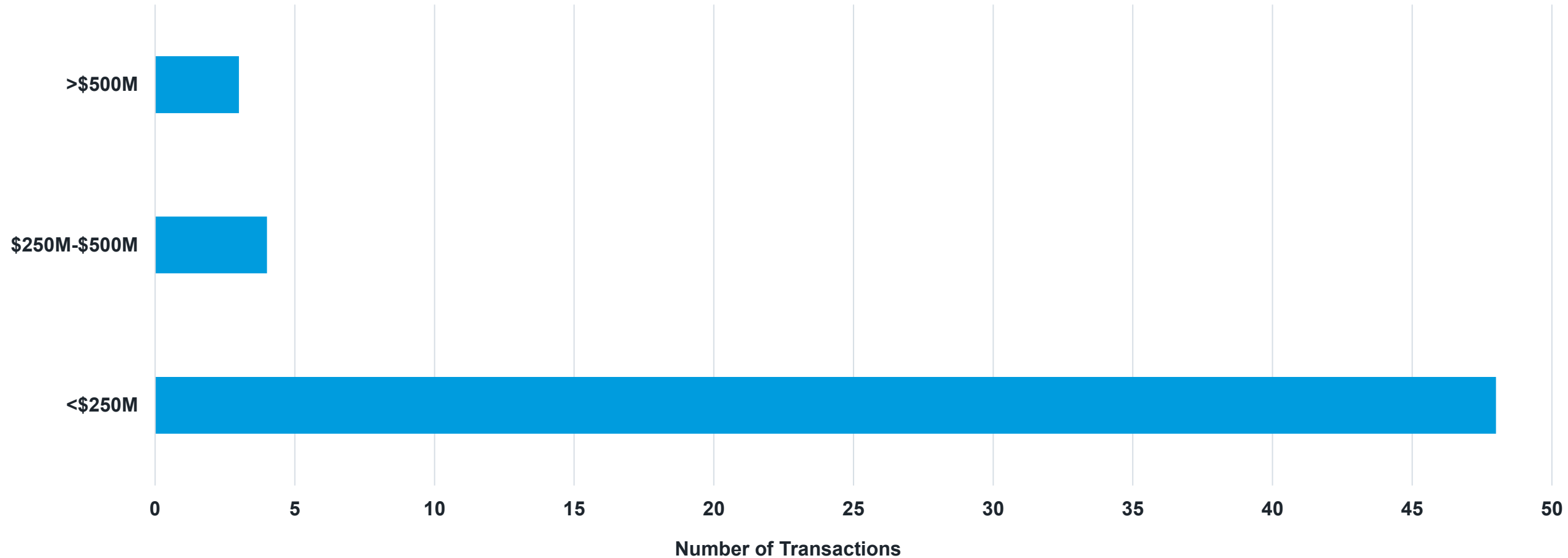


Primary Asset Class of Interests



The main asset class we saw traded in the secondaries market over the past three quarters was traditional private equity buyout fund interests, which was followed by interests in growth equity funds. There was a noticeable drop in venture and real estate secondary volume given recent market volatility.

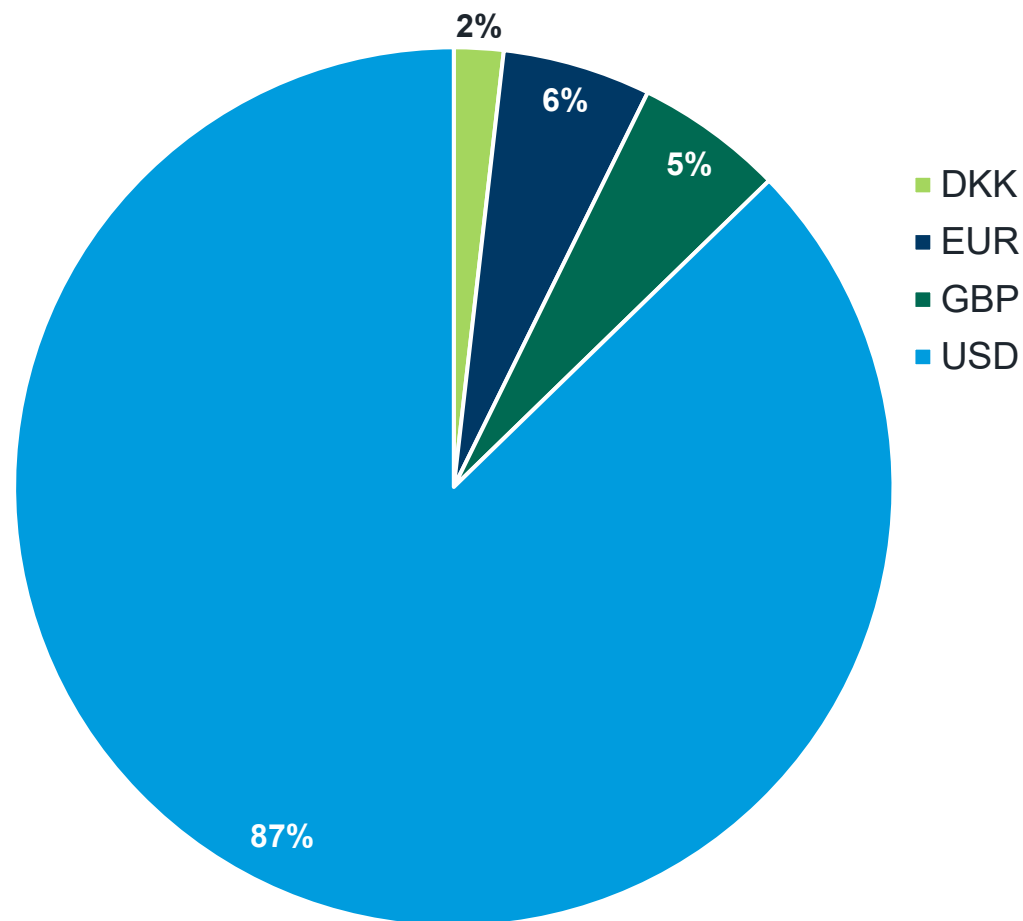
Size of Deal (in USD)



This slide shows that the vast majority of transactions we worked on had a deal value that was less than \$250m, which is reflective of the fact that most transactions over the applicable time period did not include particularly large portfolios.

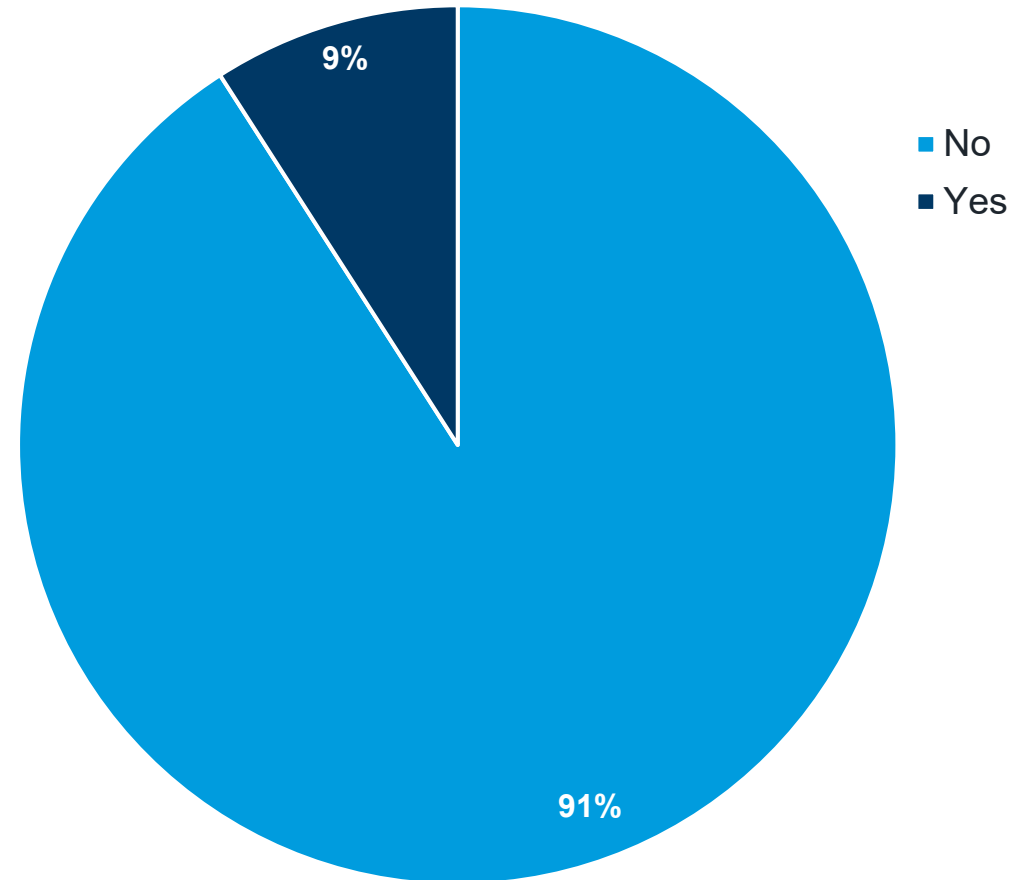
Currency

With regard to deal currency, the overwhelming majority of deals that we worked on over the relevant period were denominated in US Dollars (87%), which is reflective of the jurisdiction of the interests forming the subject of the portfolio.



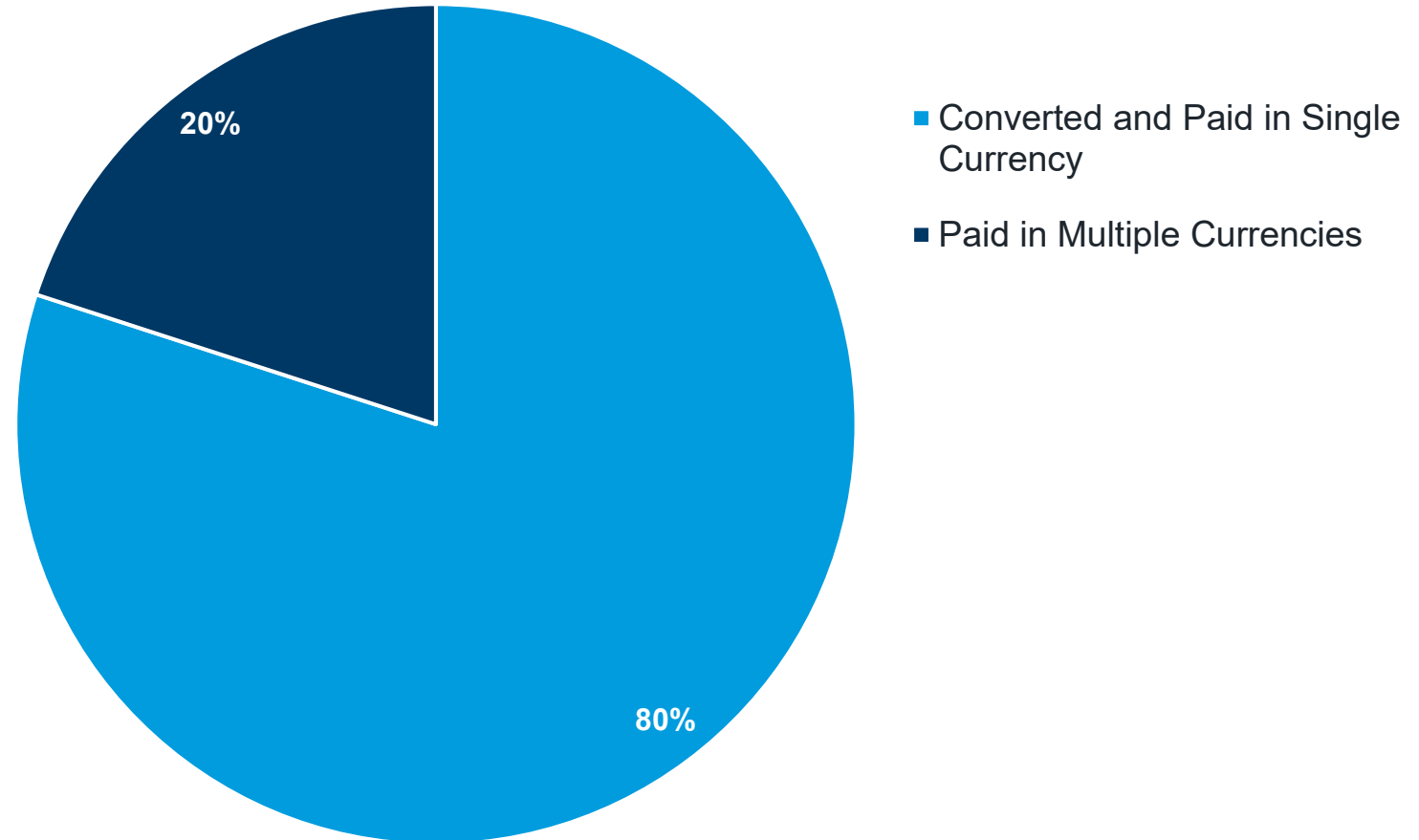
Are the Interests in the Portfolio Denominated in Multiple Currencies?

This chart illustrates that only 9% of the 55 deals that were reviewed as part of the survey were multi-currency, which would be the deals that involved portfolios spanning across multiple jurisdictions.



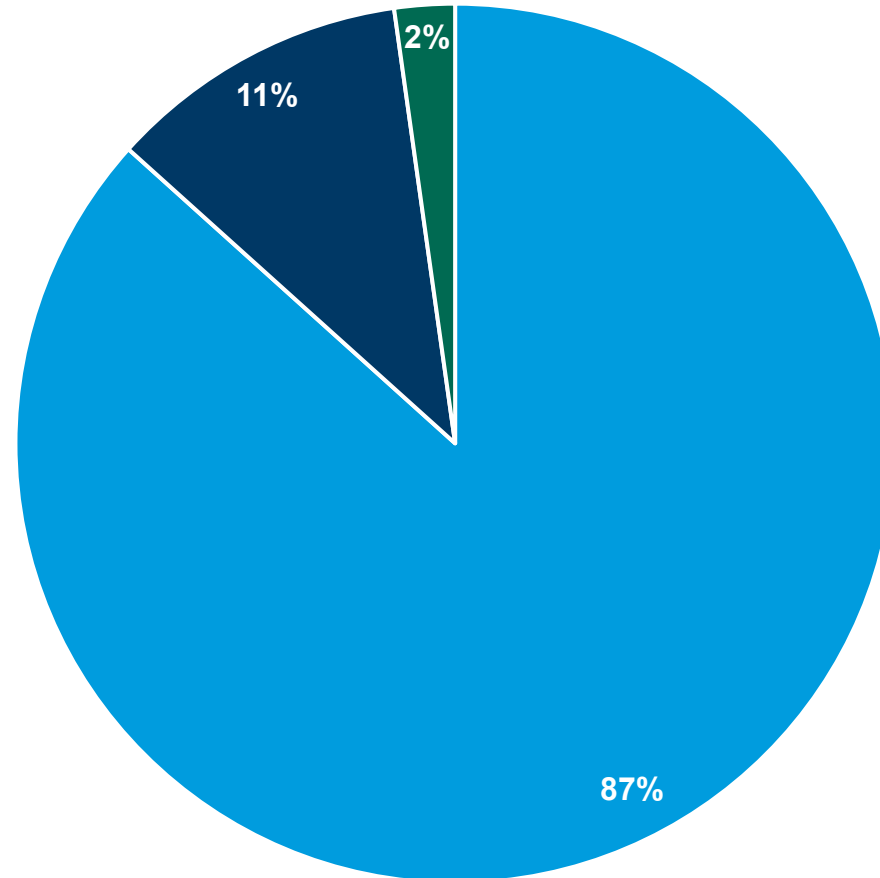
If Interests in the Portfolio Are Denominated in Multiple Currencies, How Is the Purchase Price Paid?

In deals where there were portfolios involving multiple currencies, 20% of such deals saw the purchase price for an interest calculated and paid in the applicable currency, whereas 80% of deals saw the parties agree upon a single currency for the purposes of payment. This would have involved agreeing upon a conversion method and setting out the relevant mechanics in the sale and purchase agreement, which tends to include agreeing on the appropriate date to apply when making the currency conversions.



Is Purchase Price Withholding Permitted?

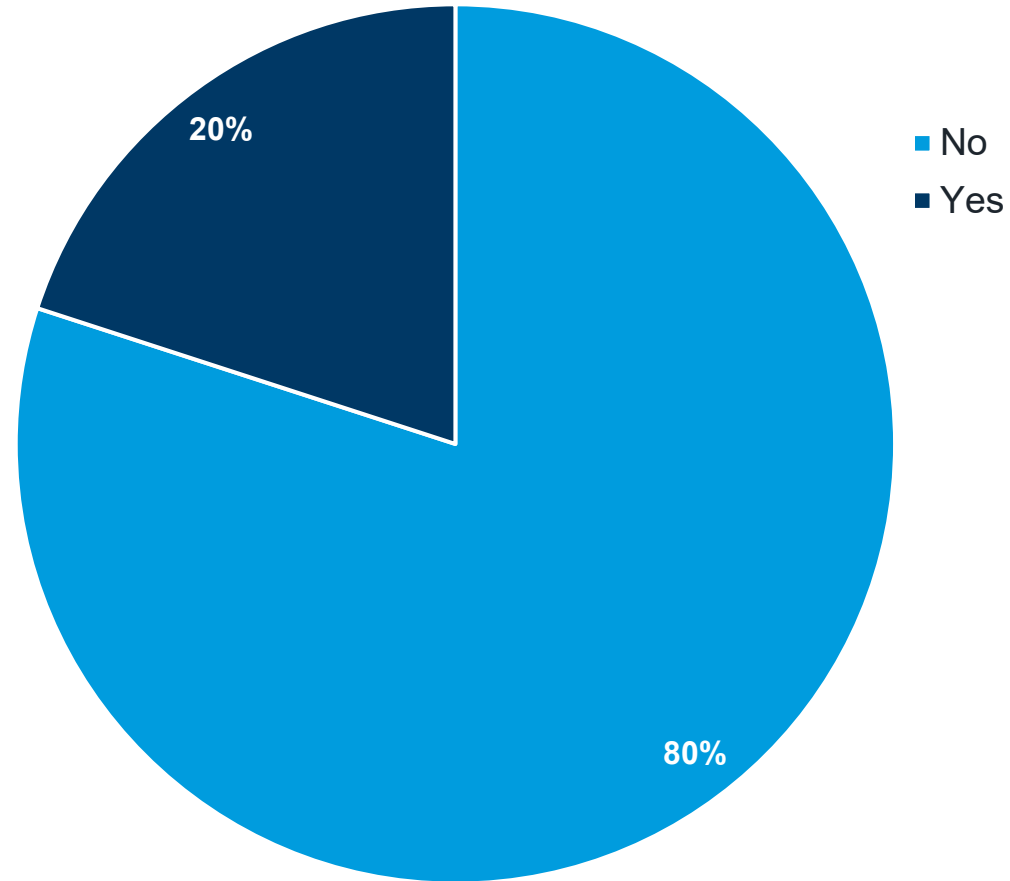
This chart touches upon what is ordinarily a heavily negotiated topic: namely, whether a buyer is permitted to withhold from the payment of the purchase price. In 87% of cases, buyers successfully negotiated a broad right to withhold amounts as required by law. In practice, this will involve careful tax due diligence to determine whether withholding is applicable in respect of any of the interests forming the subject of the portfolio.



- Buyer has broad right to withhold as required by law
- Buyer has limited right to withhold if certain conditions are met
- Buyer has no explicit right to withhold or contract forbids Buyer from withholding

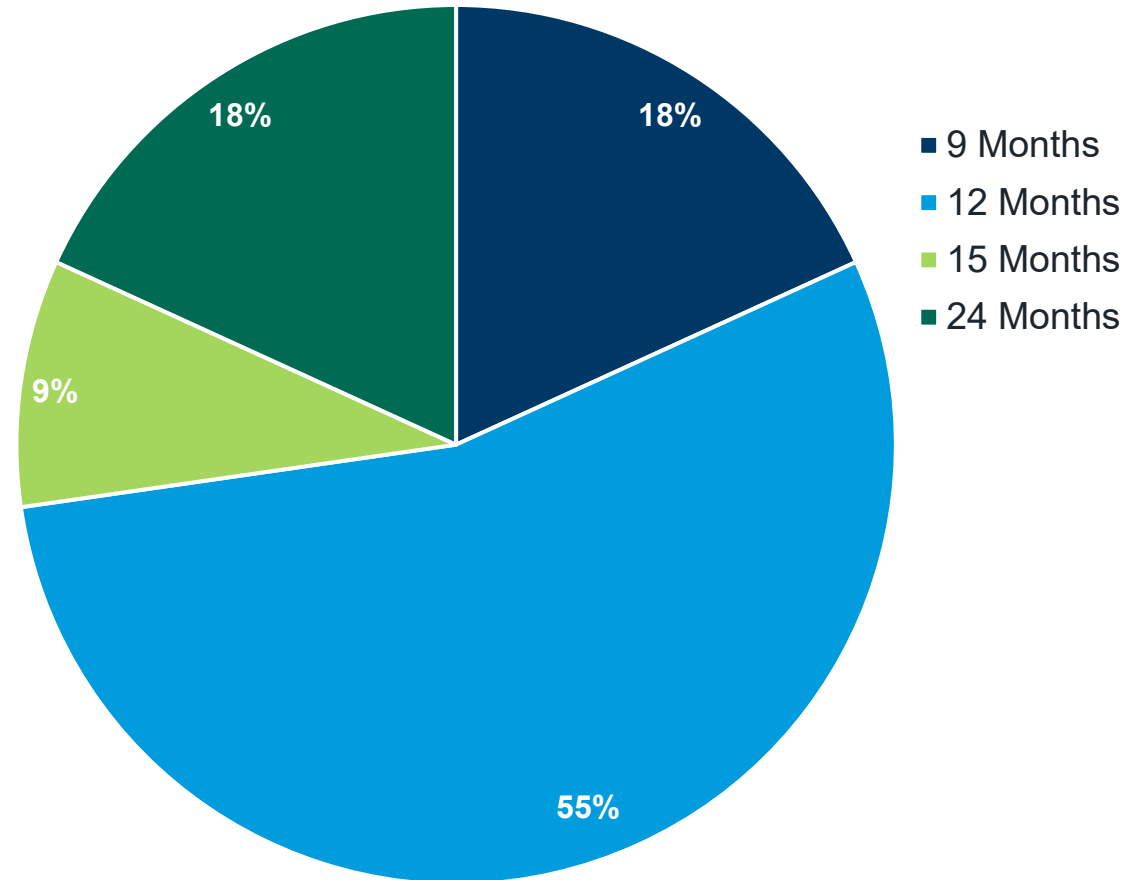
Deferred Purchase Price?

20% of our most recent deals involved a deferral of a portion of the purchase price, meaning the seller would not have received the full consideration at closing. It is worth noting that each of the three deals we worked on, with a value in excess of \$500 million, included such a deferral. This can be used as an effective tool deployed by certain buyers to bridge the bid-ask spreads seen in recent months.



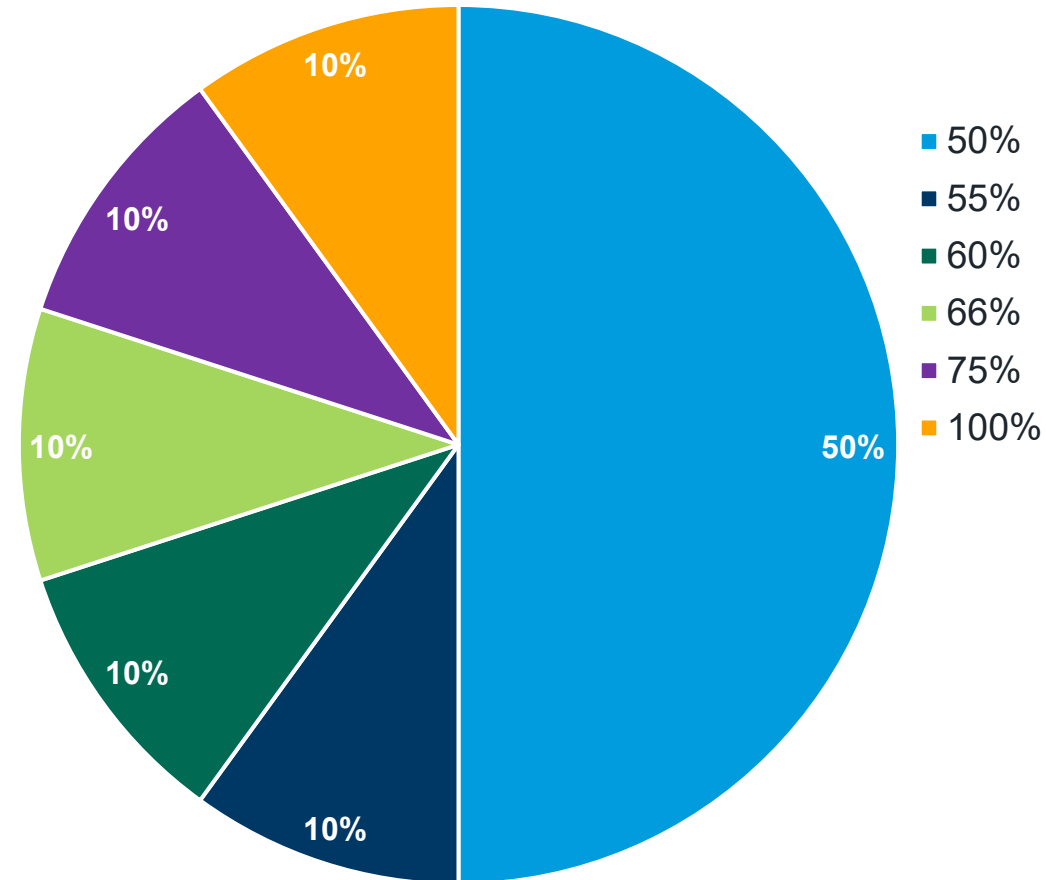
If Deferred Purchase Price, What Is the Length of Deferral?

We see here that the most common time period for deferral of the purchase price was 12 months (55%), with a 9-month and 24-month deferral period being the second-most common deferral periods (18%).



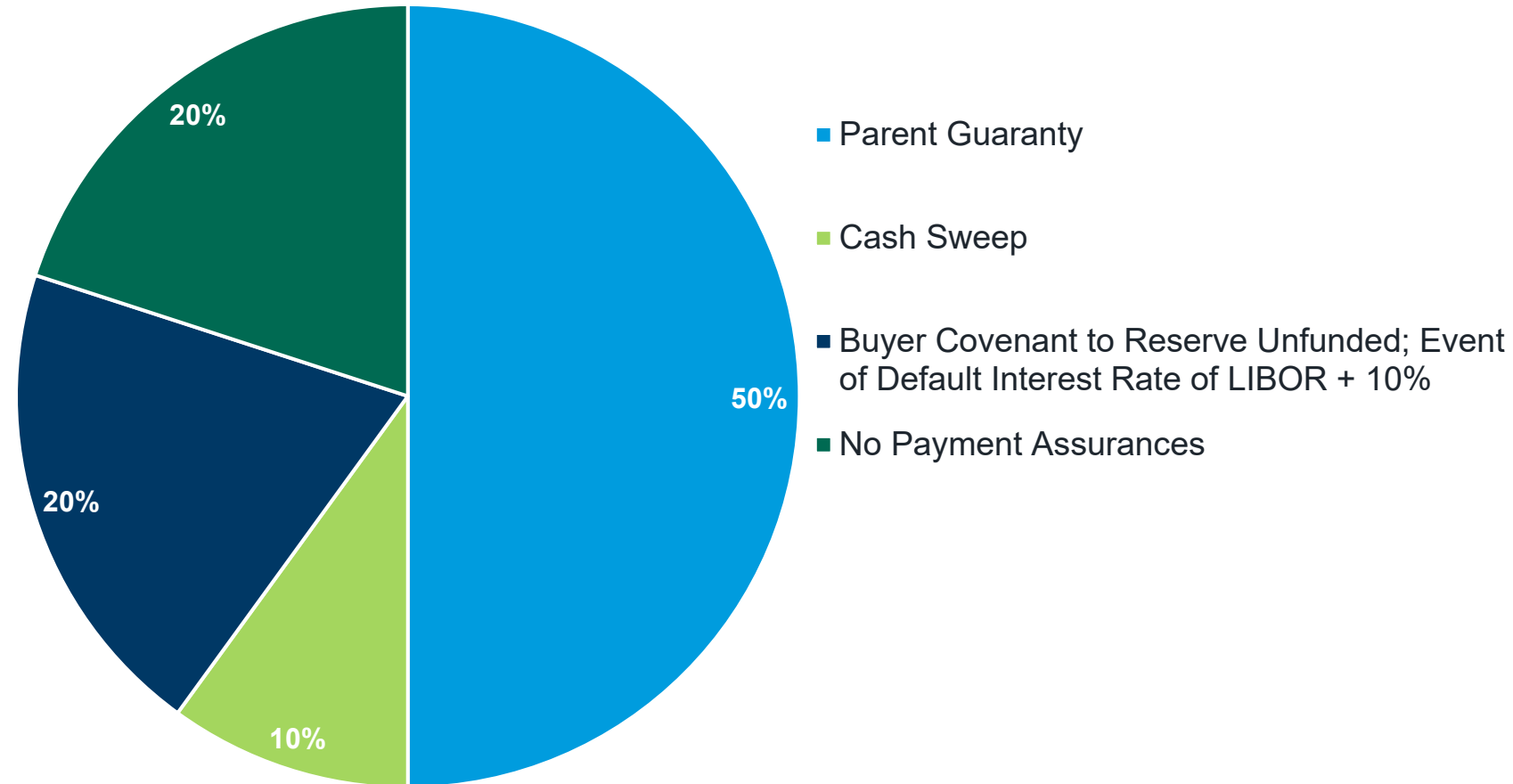
If Deferred Purchase Price, What Is the Percentage Deferred?

This chart considers the portion of the purchase price that has been deferred. Exactly 50% of our most recent deals featuring a deferral involved the deferral of 50% of the purchase price, whereas we saw deferrals of 55%, 60%, 66%, 75% and 100% each in 10% of deals.



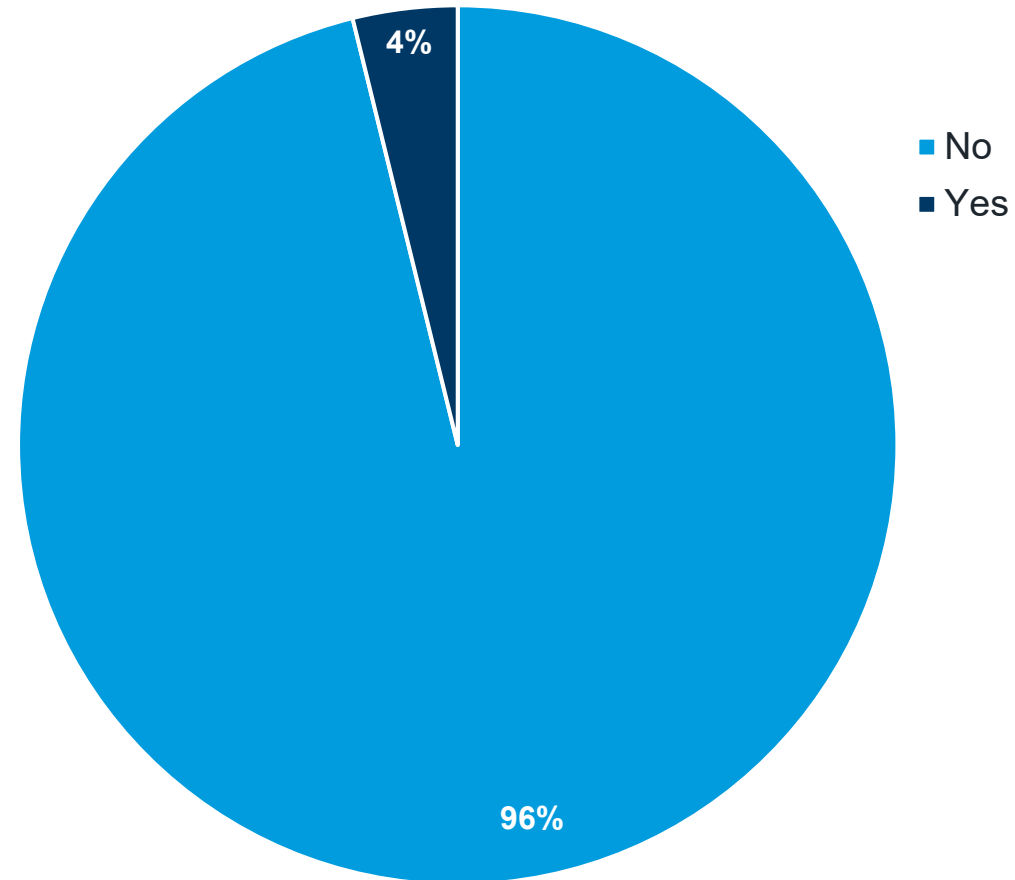
If Deferred Purchase Price, What Are the Payment Assurances?

Where there is a deferral of the purchase price, sellers will often request a number of protections that will survive until the end of the deferral period. This slide highlights that a parent guaranty is the most common form of security granted to sellers (50%). In 20% of cases, the buyer was willing to give a covenant to reserve unfunded commitments sufficient to pay the deferral and agree to certain event of default provisions. In a further 20% of deals, there were in fact no additional protections offered at all.



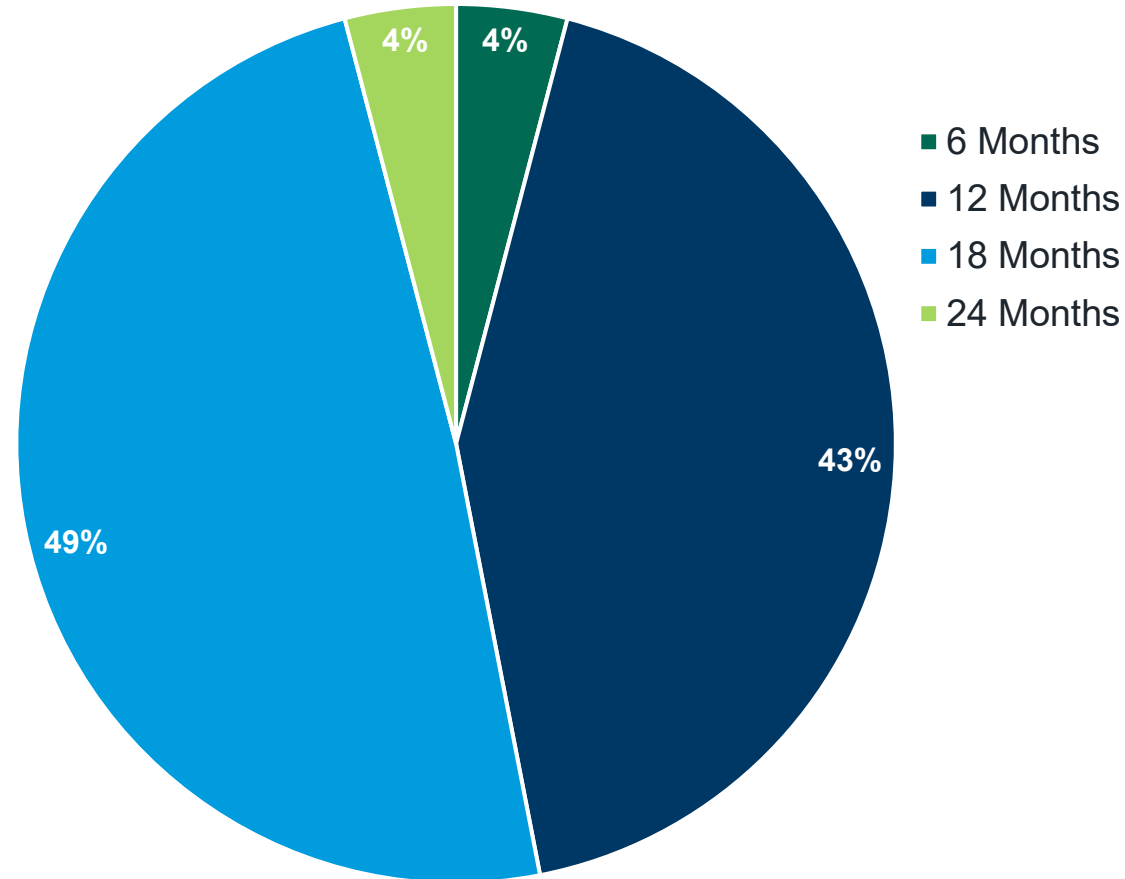
Is the Buyer Using Any Third-Party Finance?

With regard to the buy-side transactions we worked on, only 4% of deals involved third-party leverage. This is likely to be a result of the increased cost of borrowing, as well as buyers negotiating a deferral of the purchase price.



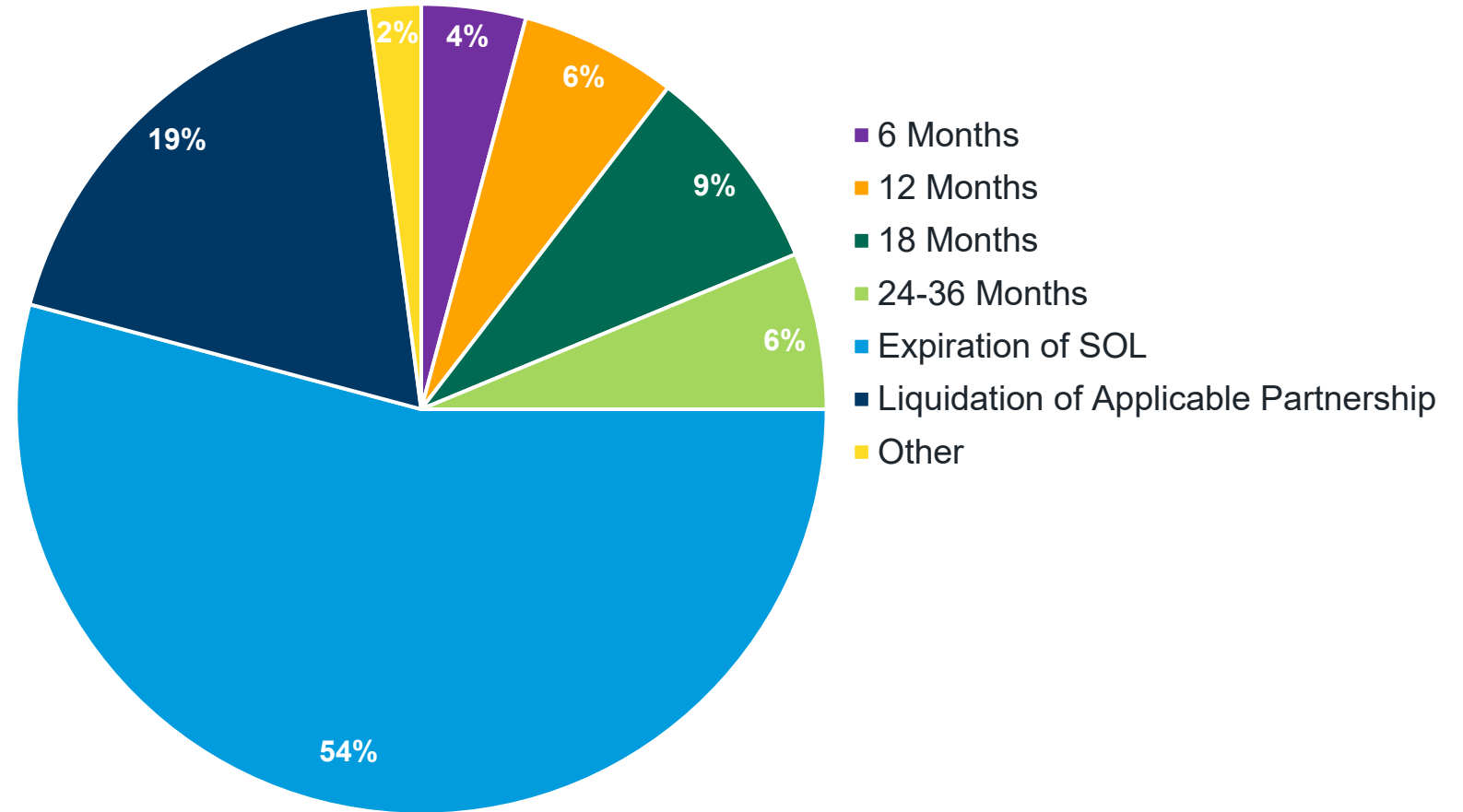
Survival Period for General Reps

Regarding the survival period for bringing claims for breach of the non-fundamental warranties, 49% of deals saw an 18-month period following the closing date, and 43% of deals saw a 12-month survival period. Such percentages are relatively consistent with data from our prior transactions, indicating that an 18-month claims period for non-fundamental warranties remains the most common position.



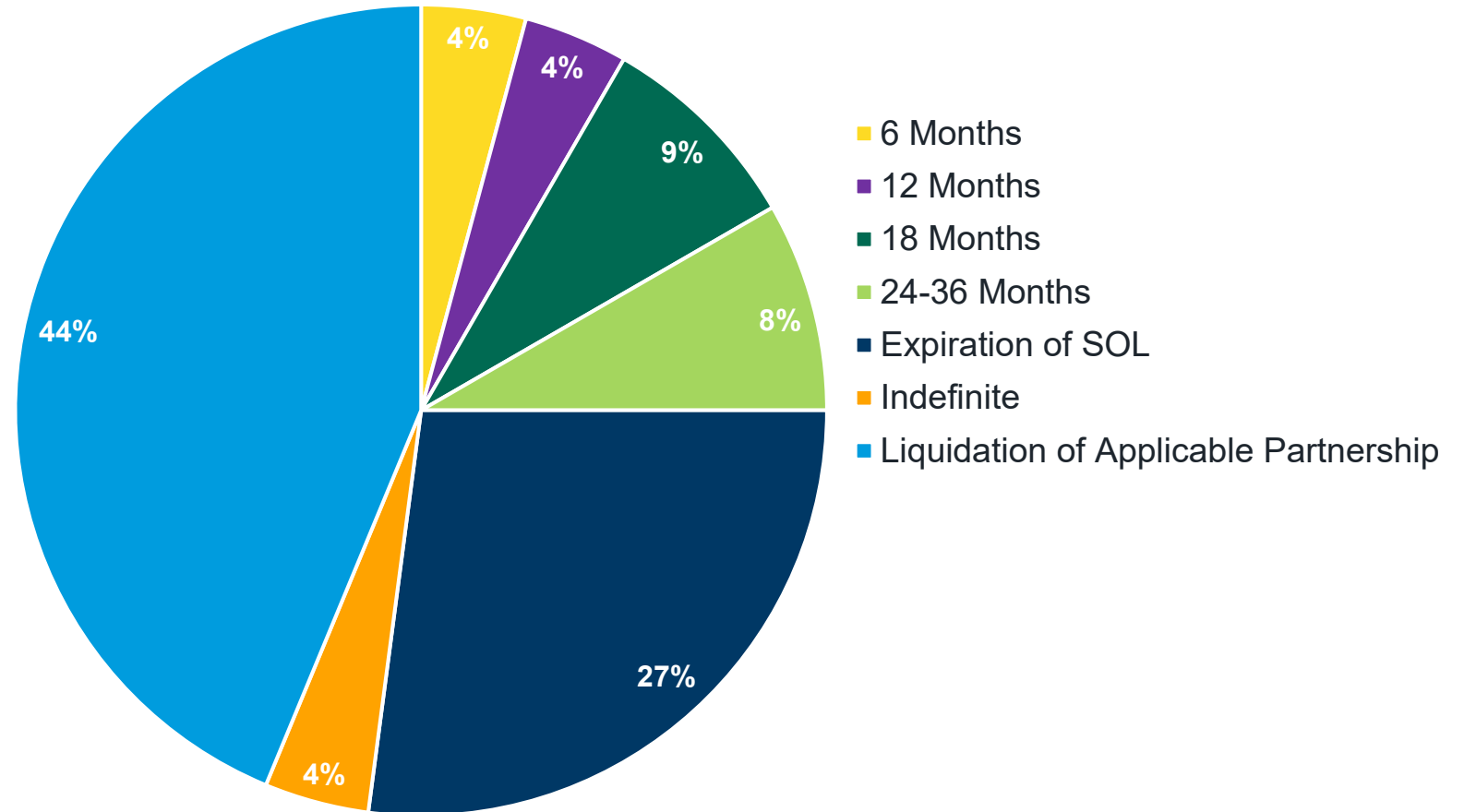
Survival Period for Fundamental Reps

As for the fundamental warranties, which tend to be the warranties relating to title, authority, no conflicts and brokers, 54% of deals saw the survival period tied to the expiration of the applicable statute of limitations and 19% by reference to the liquidation of the applicable partnership.



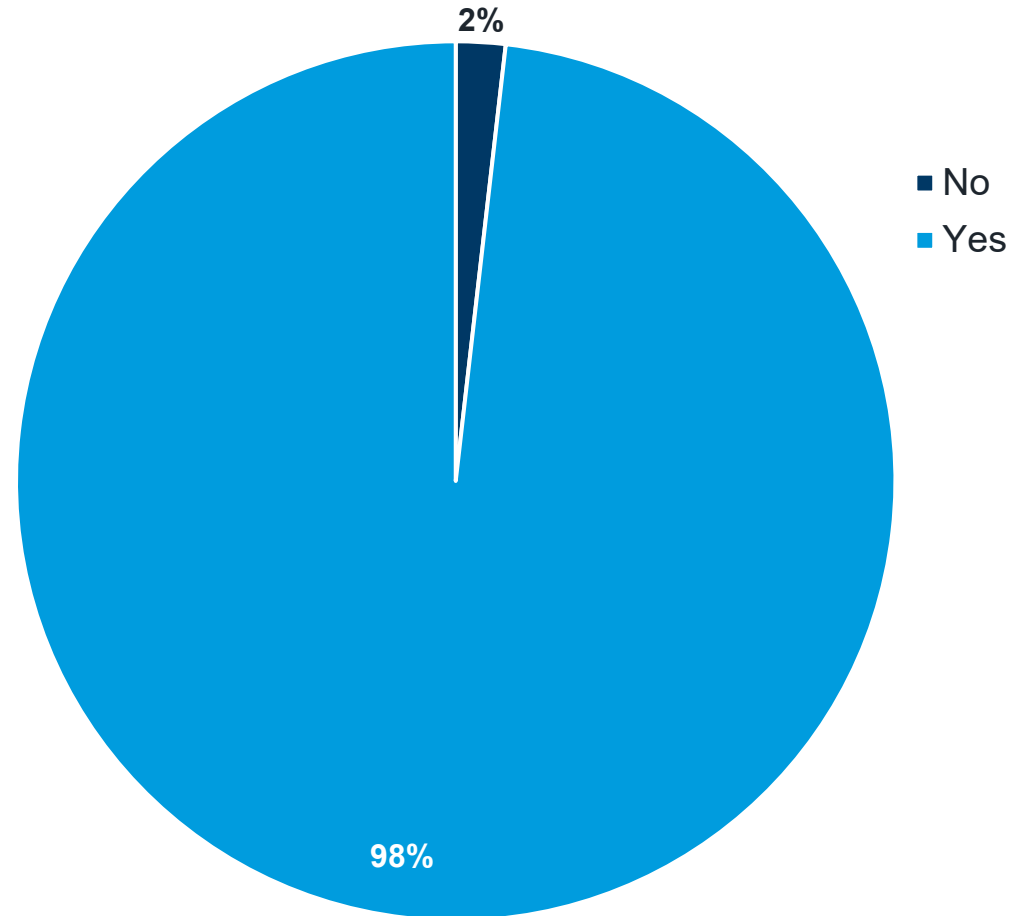
Survival Period for Title Reps

Looking more closely at the title warranty, which most would agree is the most important of the fundamental warranties, in 44% of deals the survival period for bringing claims for breach of such warranty was the liquidation of the applicable partnership. Second in line was the expiration of the statute of limitations, in 27% of deals.



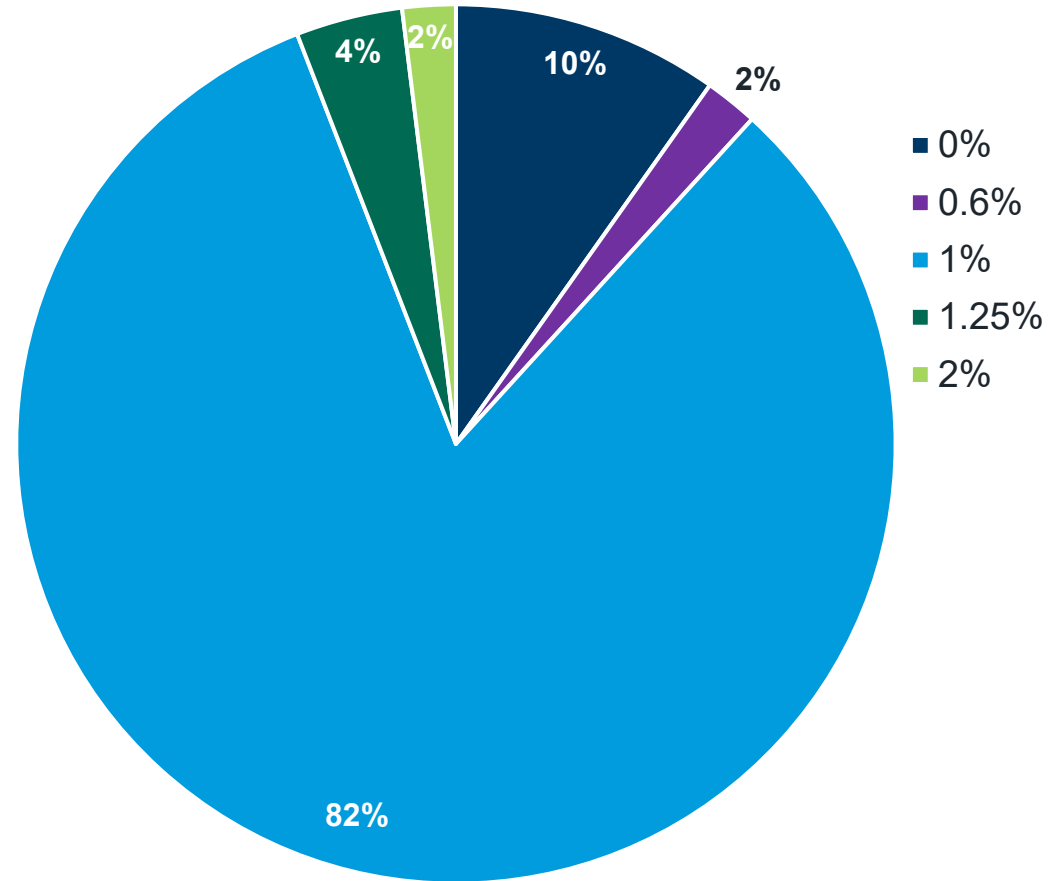
Indemnity?

As is customary, 98% of secondaries sale and purchase agreements saw the parties granting one another an indemnity in respect of certain claims. The scope of the indemnity given by each party is subject to negotiation, but typically includes: (i) any inaccuracy in or breach of any rep or warranty contained in the PSA or the transfer documents; (ii) any failure to perform any covenant, agreement or obligation contained in the PSA or the transfer documents; (iii) any claim by any person for any finder's or broker's fees; and (iv) a seller indemnity for the excluded obligations.

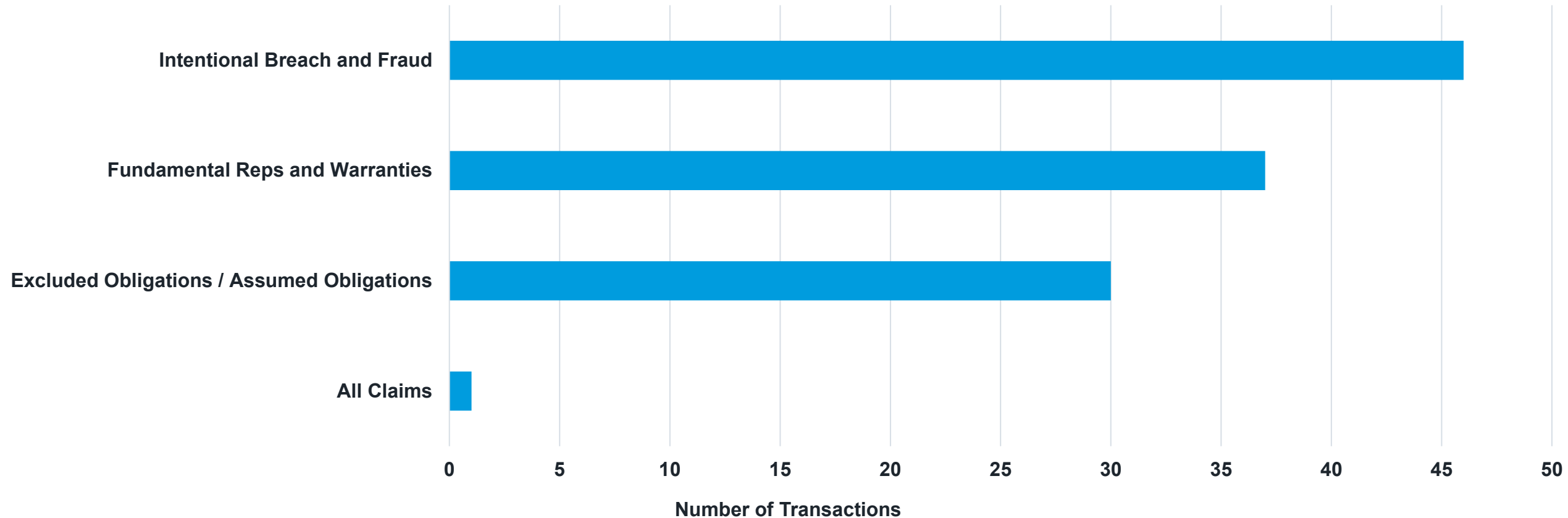


Indemnity Threshold

The threshold for indemnity claims is typically pegged to a percentage of the purchase price and means that a party cannot bring an indemnity claim until the relevant threshold is hit. In 82% of deals, such threshold was set at 1% of the purchase price, which continues to be a relatively standard position.



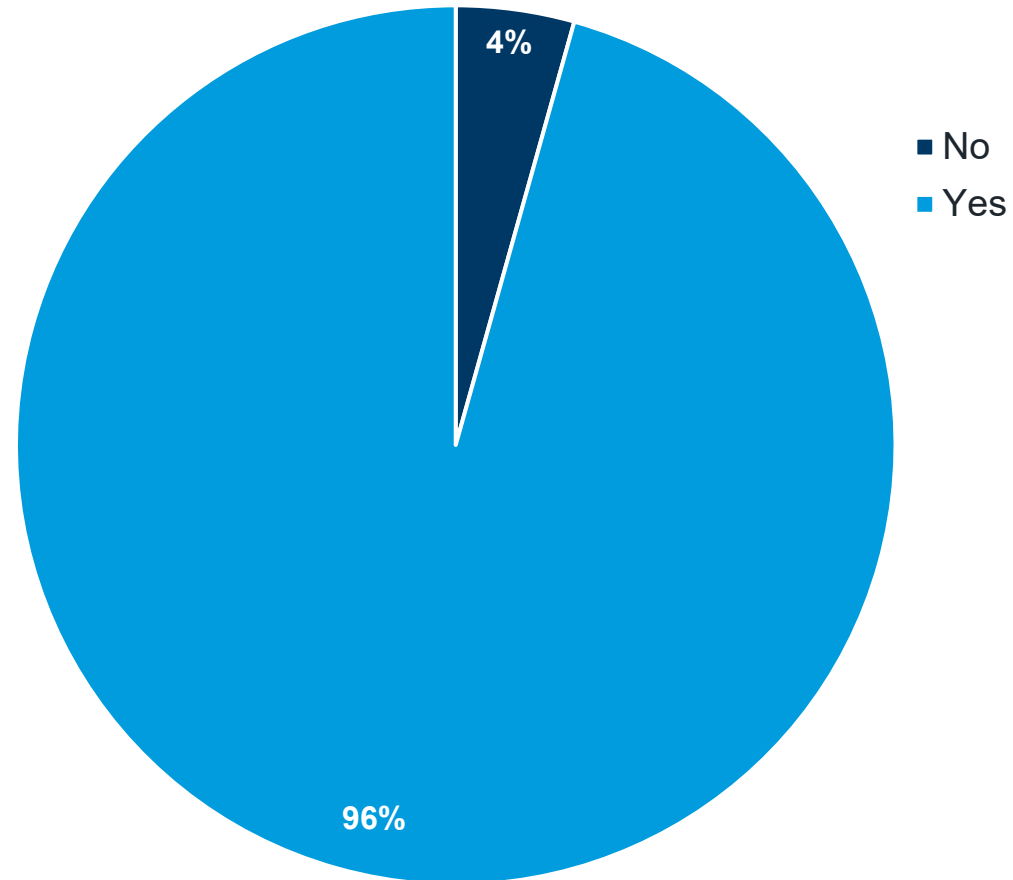
Types of Claims Not Subject to the Threshold?



This slide shows the types of claims carved out of the financial limitations. Regarding the applicability of any financial limitations, the preferred buyer position is to apply the financial limitations to breach of the non-fundamental representations only, which would mean that all other types of indemnity claims would not be subject to any financial limitations whatsoever. Sellers, however, tend to push to apply the financial limitations to all indemnity claims.

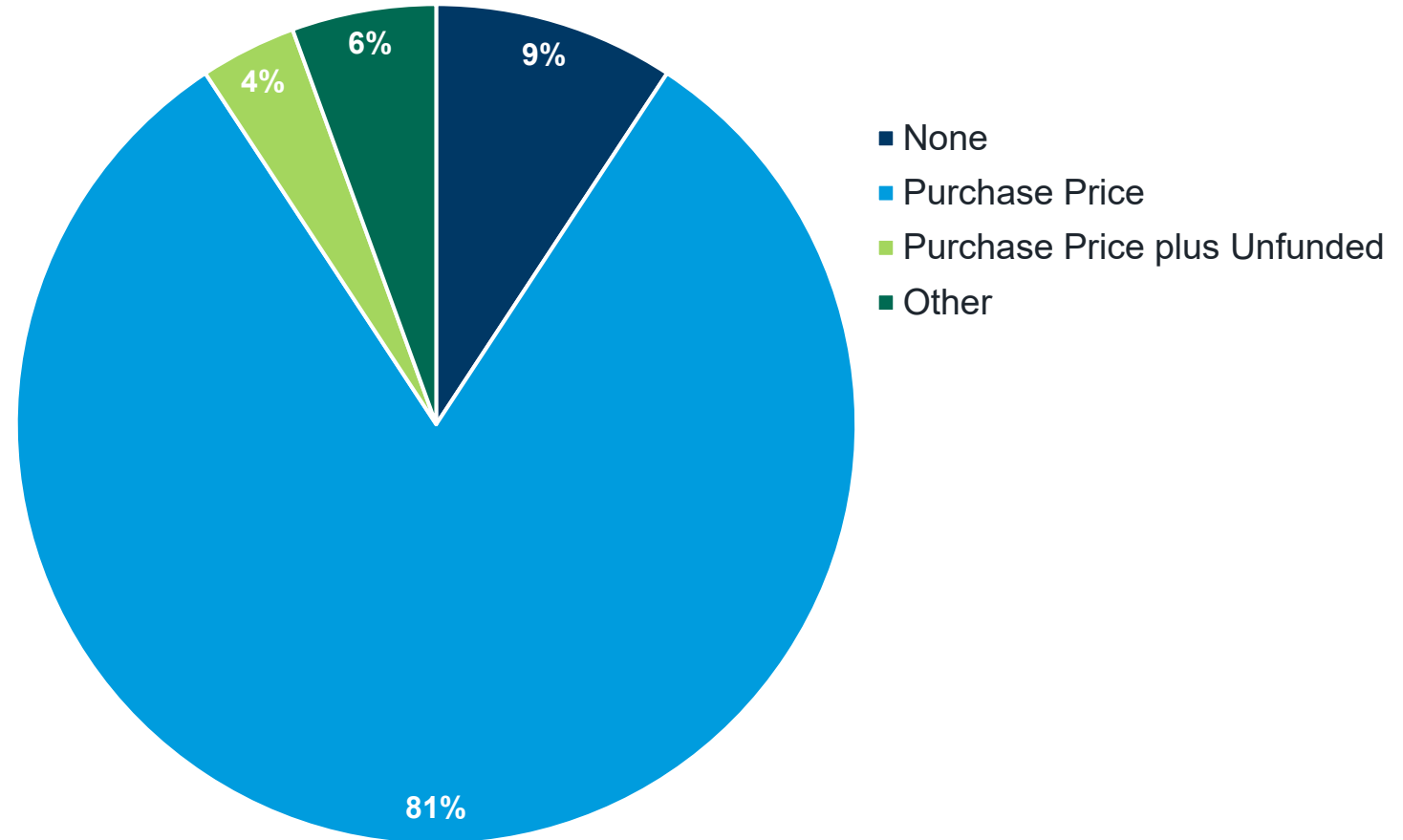
After Threshold, Recover from Dollar-One?

As shown in this chart, once the threshold is hit, the total amount of the indemnity claim is ordinarily recoverable from the very first dollar and without regard to the threshold. Only in 4% of cases did the parties agree to treat the threshold as a deductible so that only amounts above such threshold could be recovered.

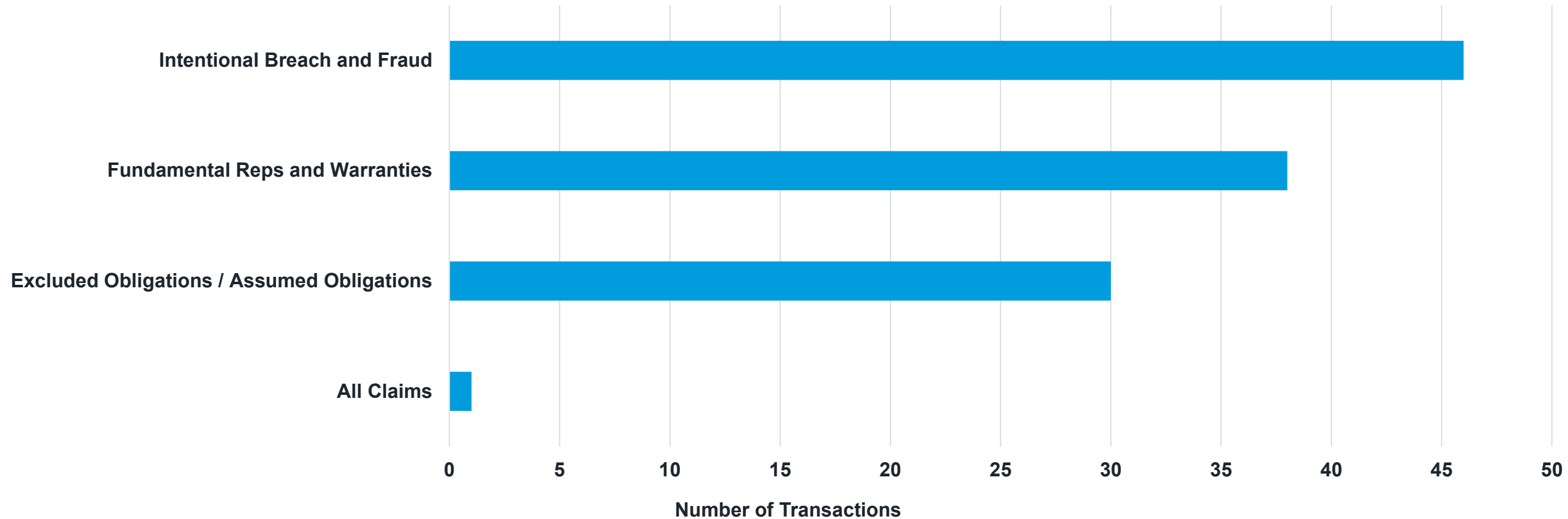


Indemnity Cap

With regard to an overall cap for indemnity claims – i.e. the maximum amount payable by one party to another – this slide clearly shows that in the vast majority of cases (81%) this is set at the purchase price.

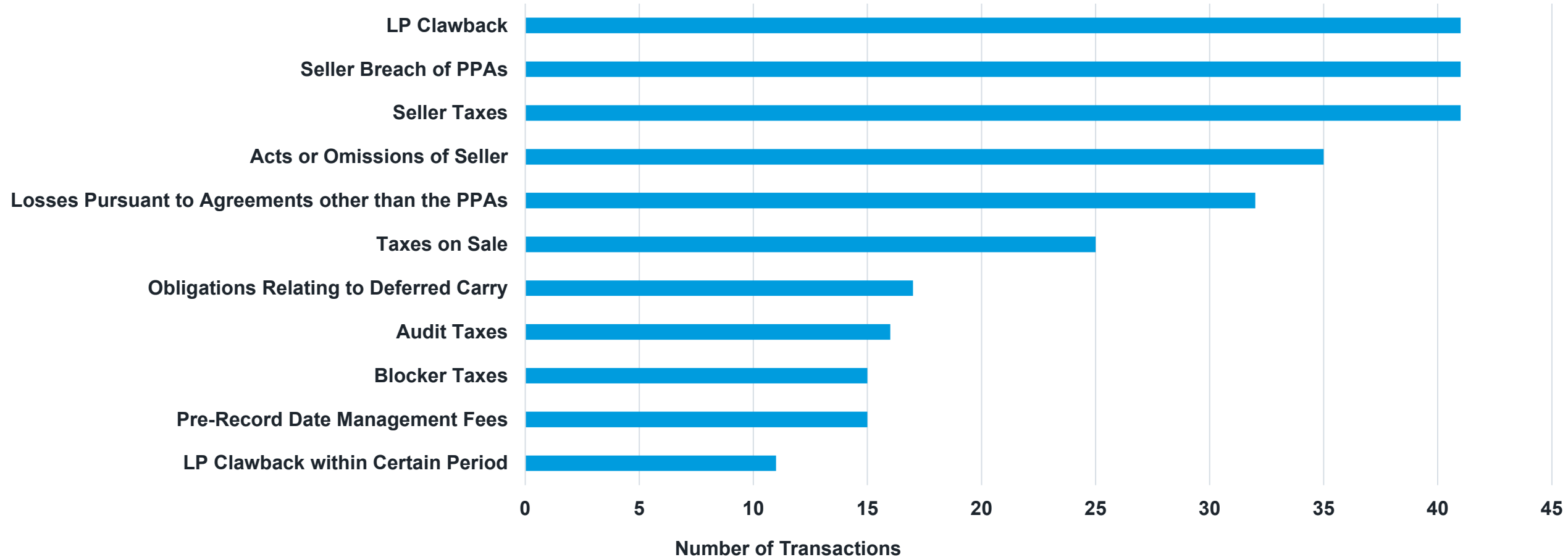


Types of Claims Not Subject to the Cap?



The types of indemnity claims that the overall cap applies to more often than not mirror what the parties agree with in respect to the threshold, as is largely reflected on this chart.

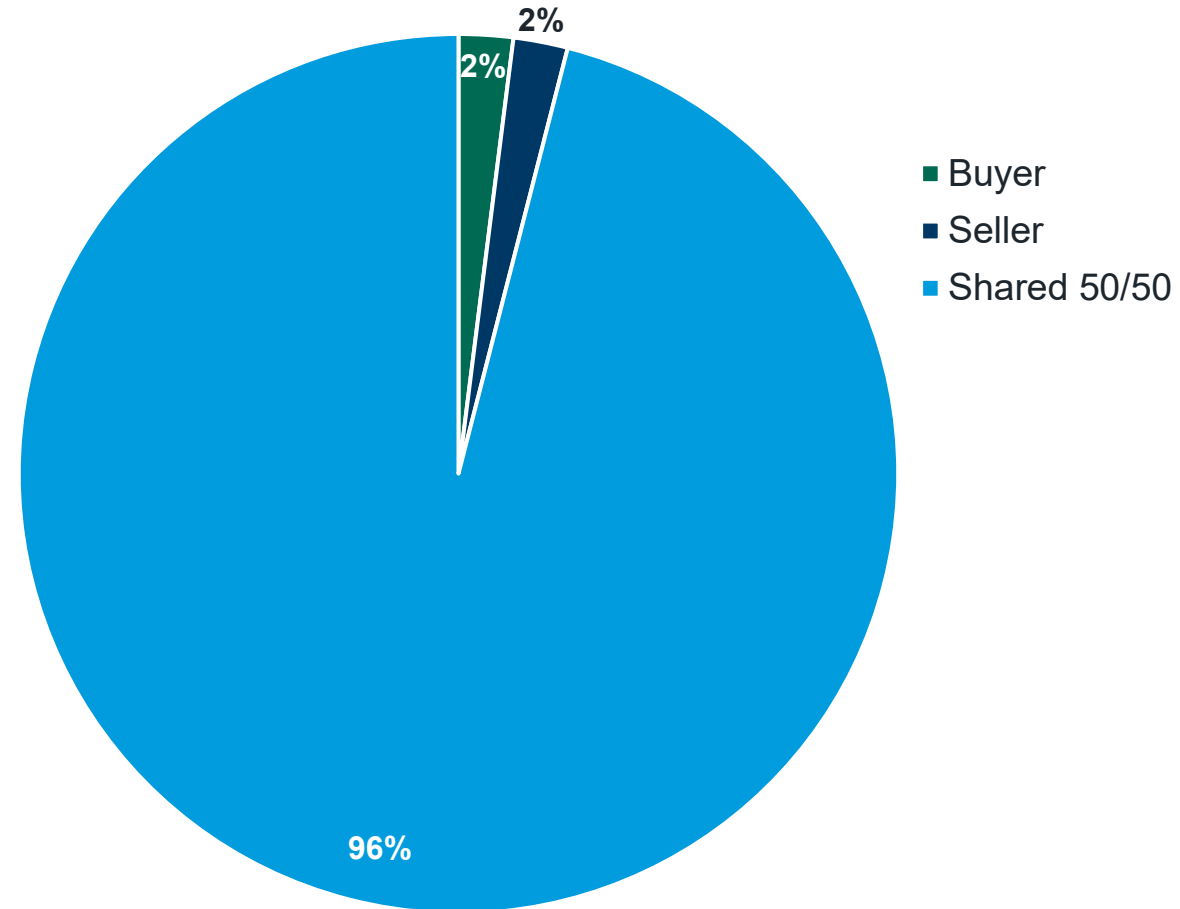
Excluded Obligations Include:



This chart illustrates the various limbs of the excluded obligations being negotiated between buyers and sellers. It is worth noting certain relatively new limbs of the excluded obligations, covering any deferrals or waivers of pre-record date management fees and carried interest, which we have been successfully negotiating on behalf of our buy-side clients.

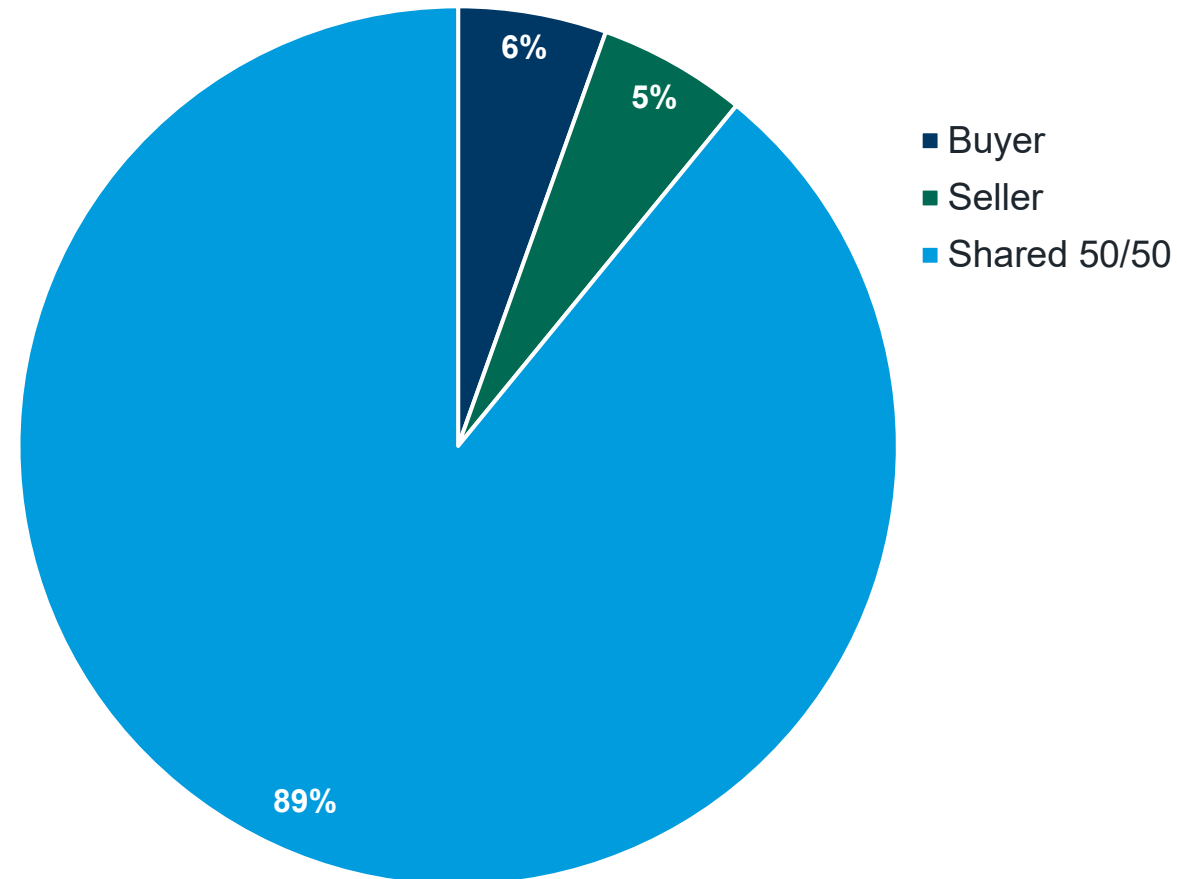
Transfer Expenses Borne by Which Party?

As is relatively market standard, the expenses incurred by the underlying GPs were shared equally between the buyer and seller in 96% of cases.



Transfer Taxes Borne by Which Party?

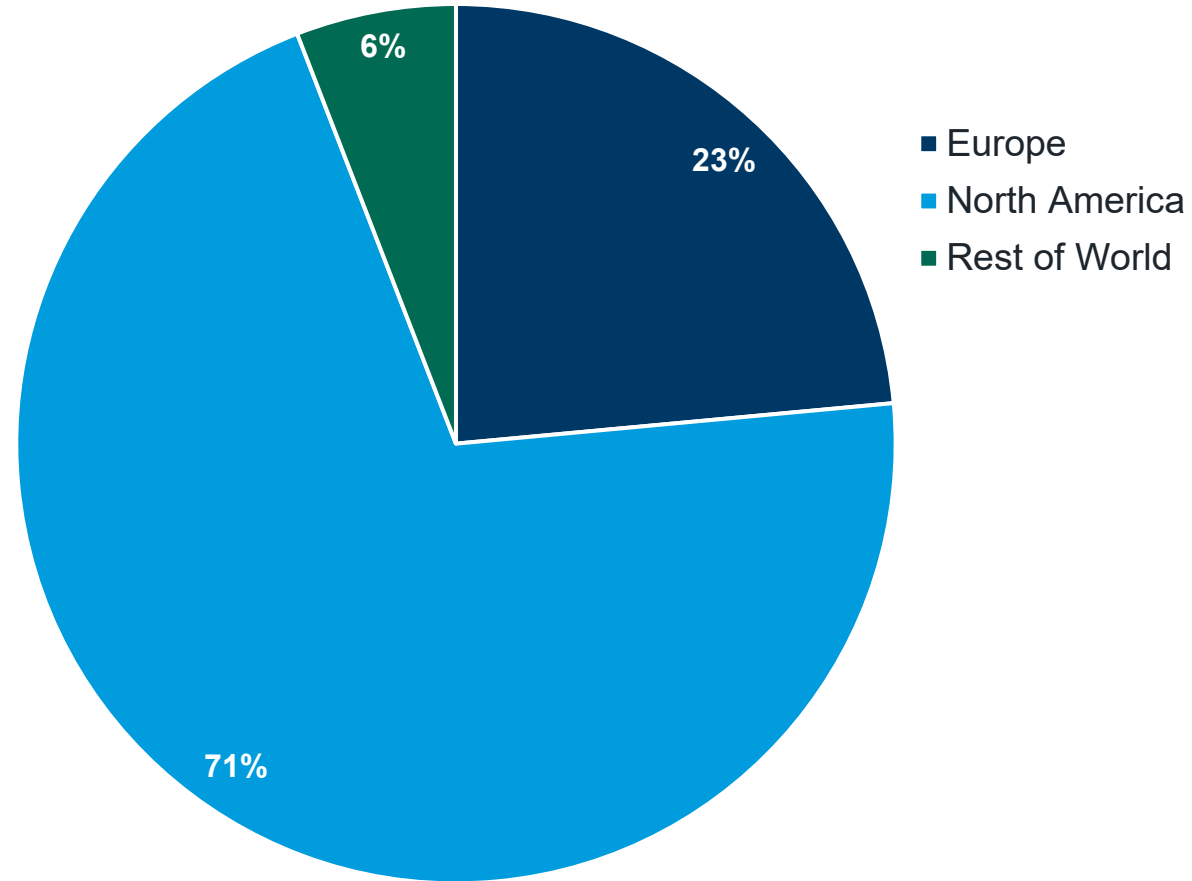
In the event transfer taxes were to arise in connection with the interests being transferred, the parties agreed that they would be shared on a 50/50 basis between the buyer and seller in 89% of deals.



Data Insights: GP-Led Secondaries Transactions

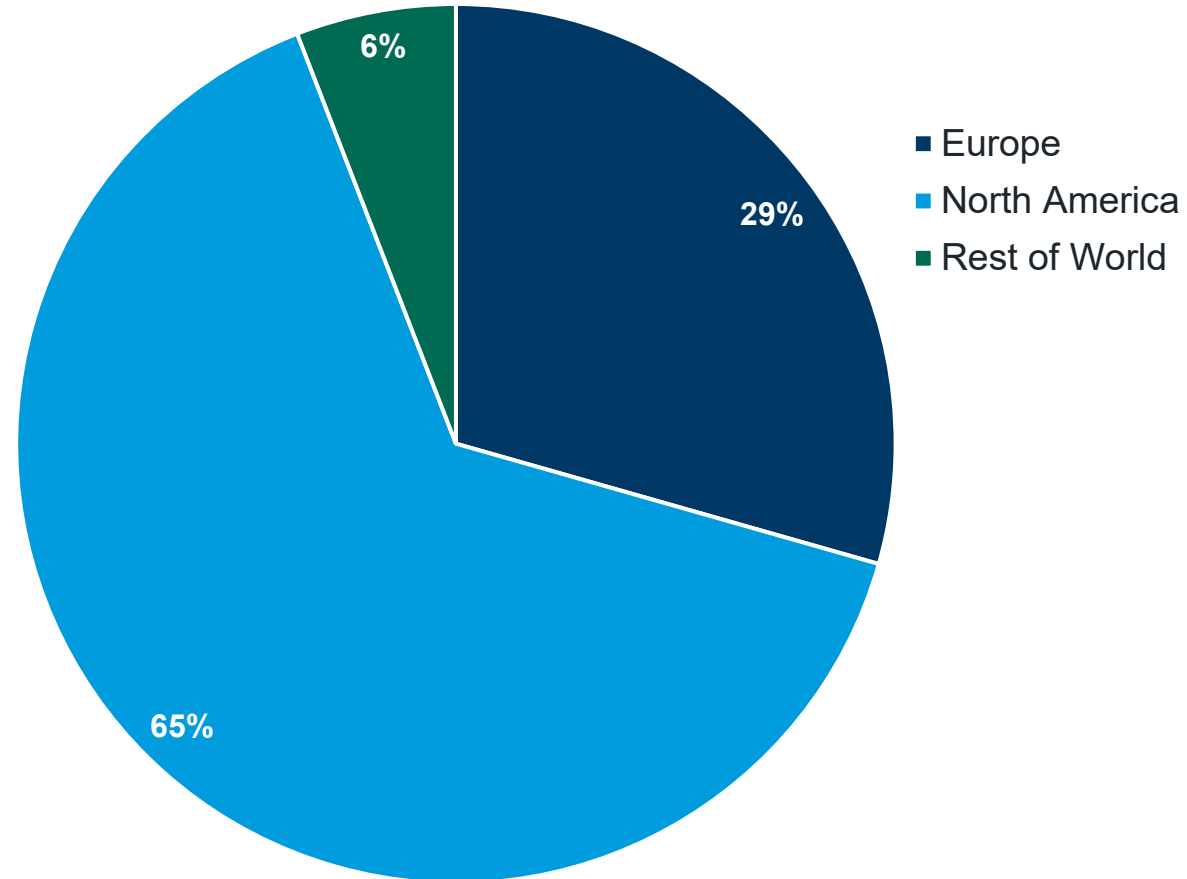
Sponsor Geography

This chart highlights the principal jurisdiction of the sponsors, with the largest representations being the USA (71%) and Europe (23%). We saw smaller percentages of sponsors based in other parts of the world.



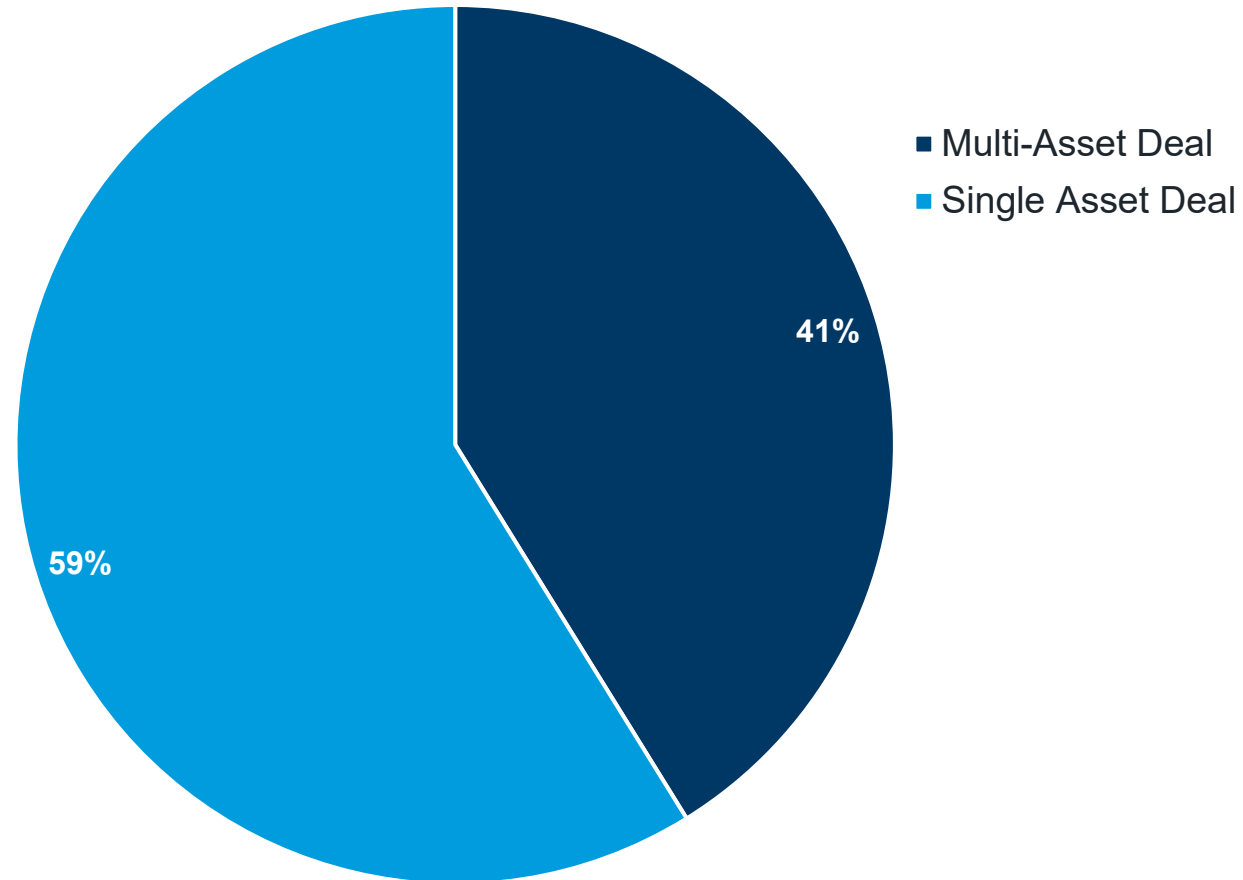
Portfolio Geography

This chart highlights the principal jurisdiction of the subject portfolio companies, with the largest representations being North America (65%) and Europe (29%). We saw smaller percentages in other parts of the world.



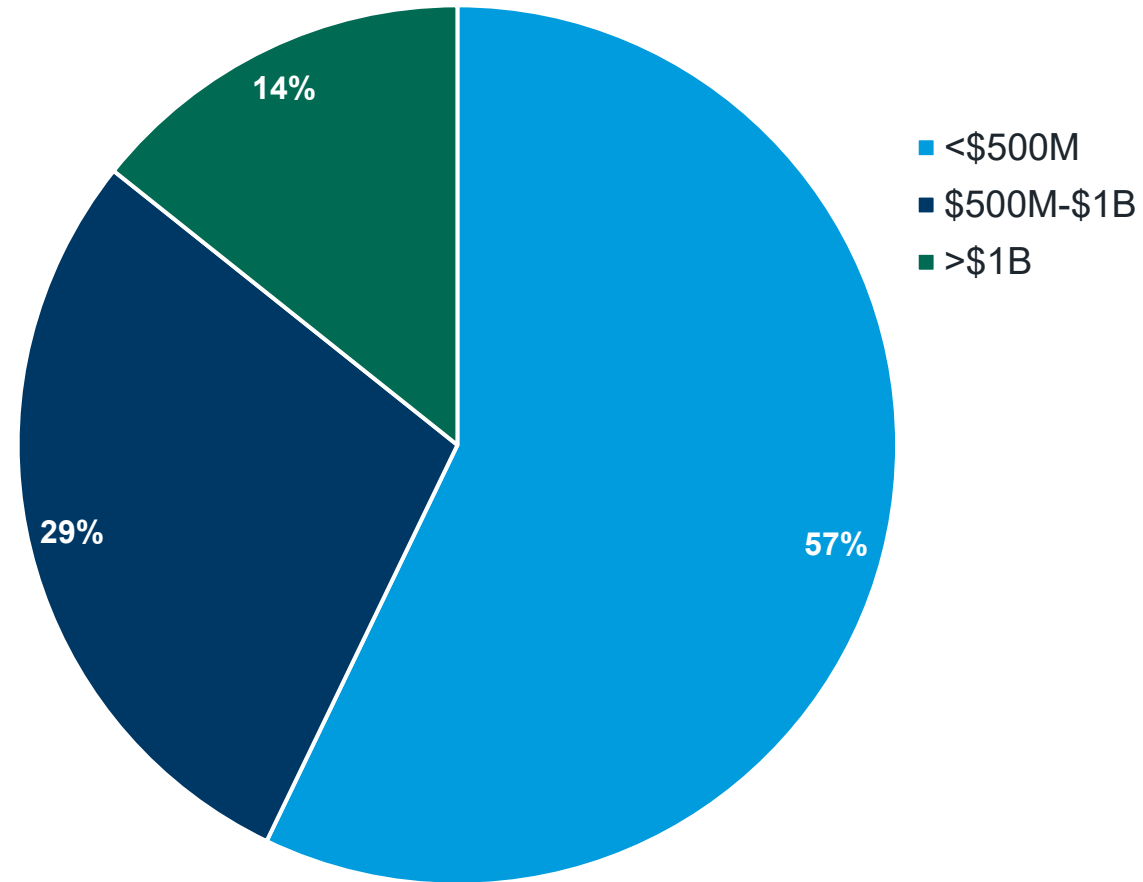
Single Asset Deal or Multi-Asset Deal?

The last year has seen increased interest in single asset deals, with those transactions making up 59% of the GP-led transactions our teams worked on in the second half of 2022 and first quarter of 2023.

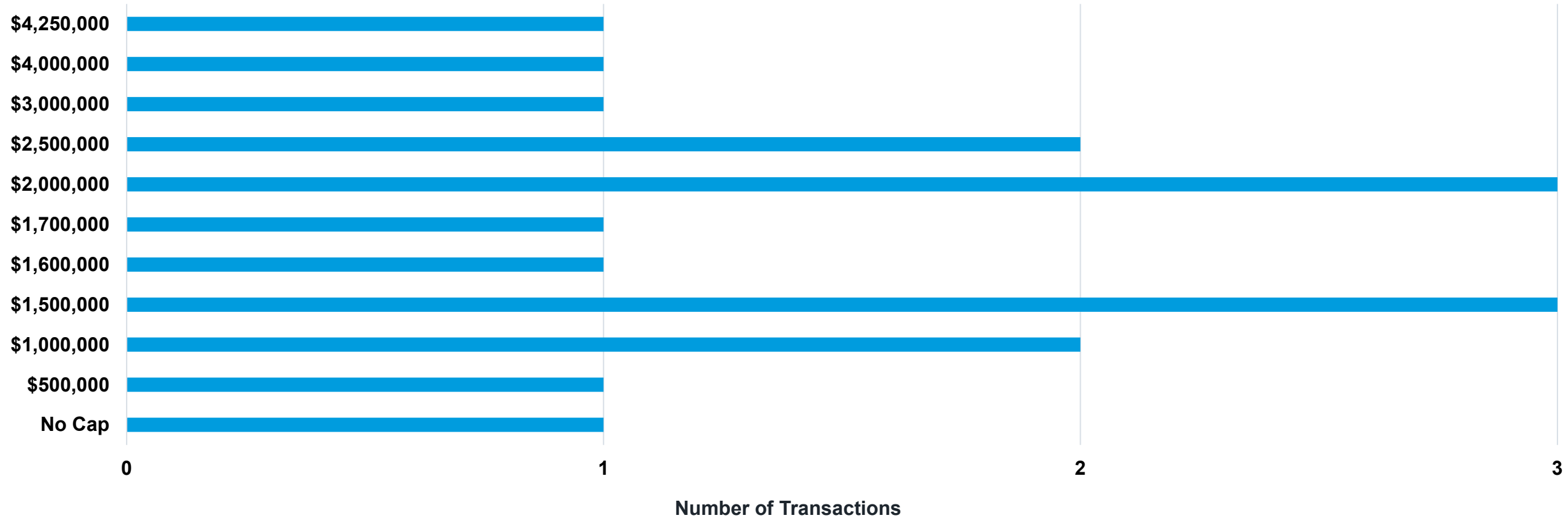


Size of Deal

The majority of the GP-led deals worked on over the applicable time period were slightly smaller in size, with an overall deal size of less than \$500 million.



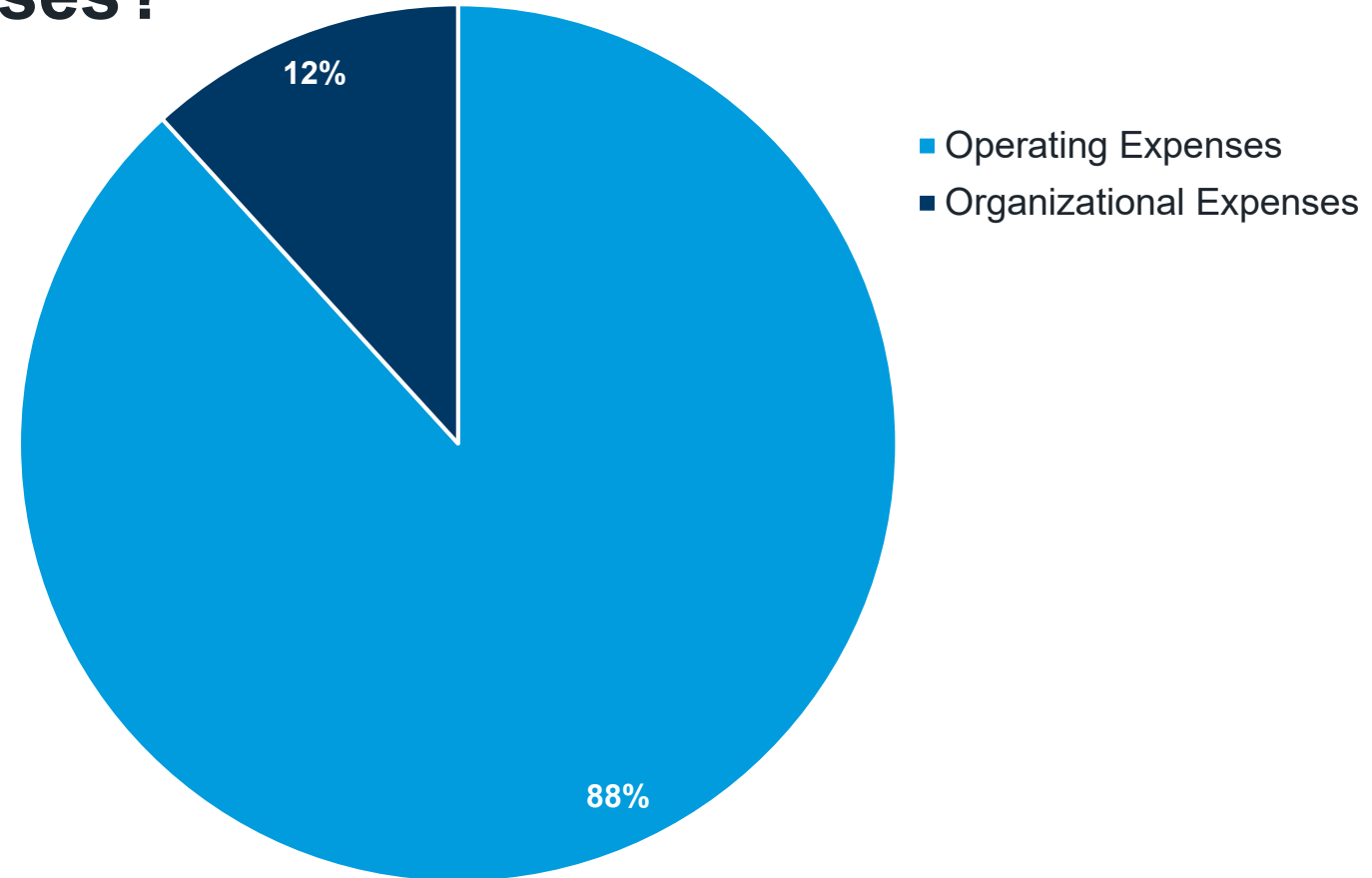
Organizational Expense Cap



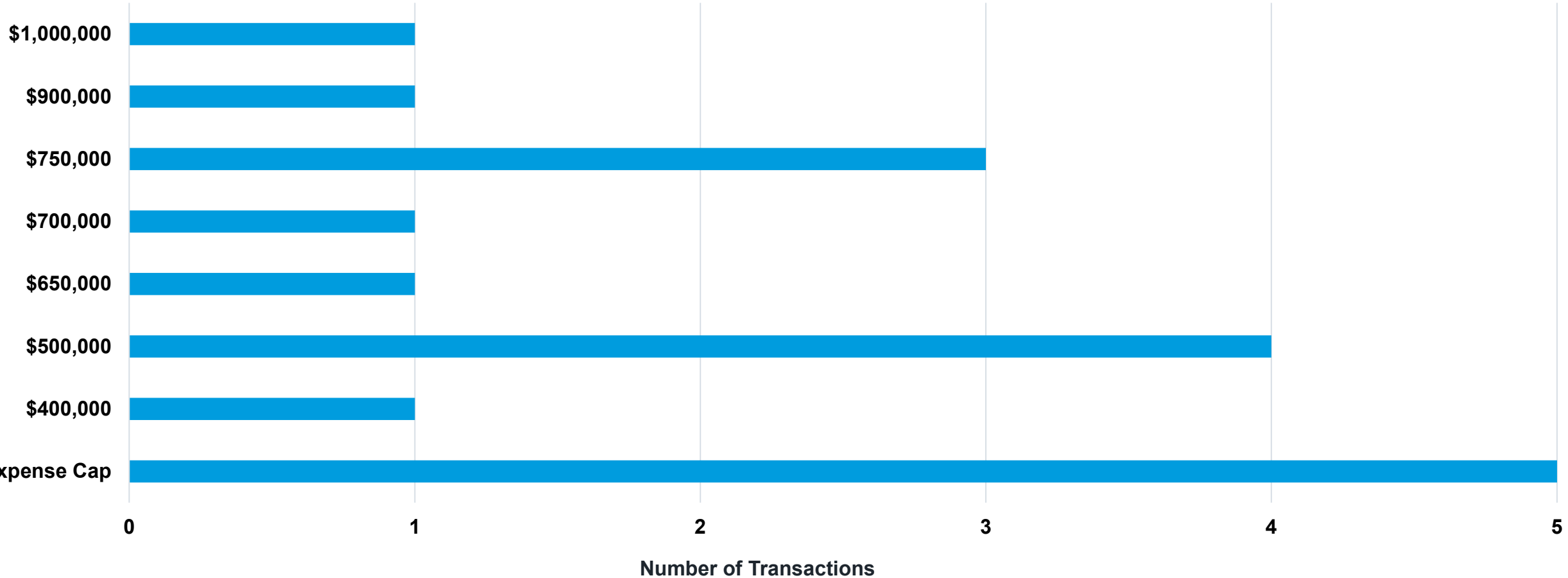
Recent transactions have seen increases in organizational expense caps for GP-led transactions.

Are Lead Investor Expenses Treated as Organizational Expenses or Operating Expenses?

The vast majority of transactions do not include lead investor expenses in the applicable continuation fund's organizational expenses. Transactions that do include lead investor expenses in the definition of organizational expenses will correspondingly increase the caps of organizational expenses, which could contribute to some of the higher caps we saw on the prior slide.

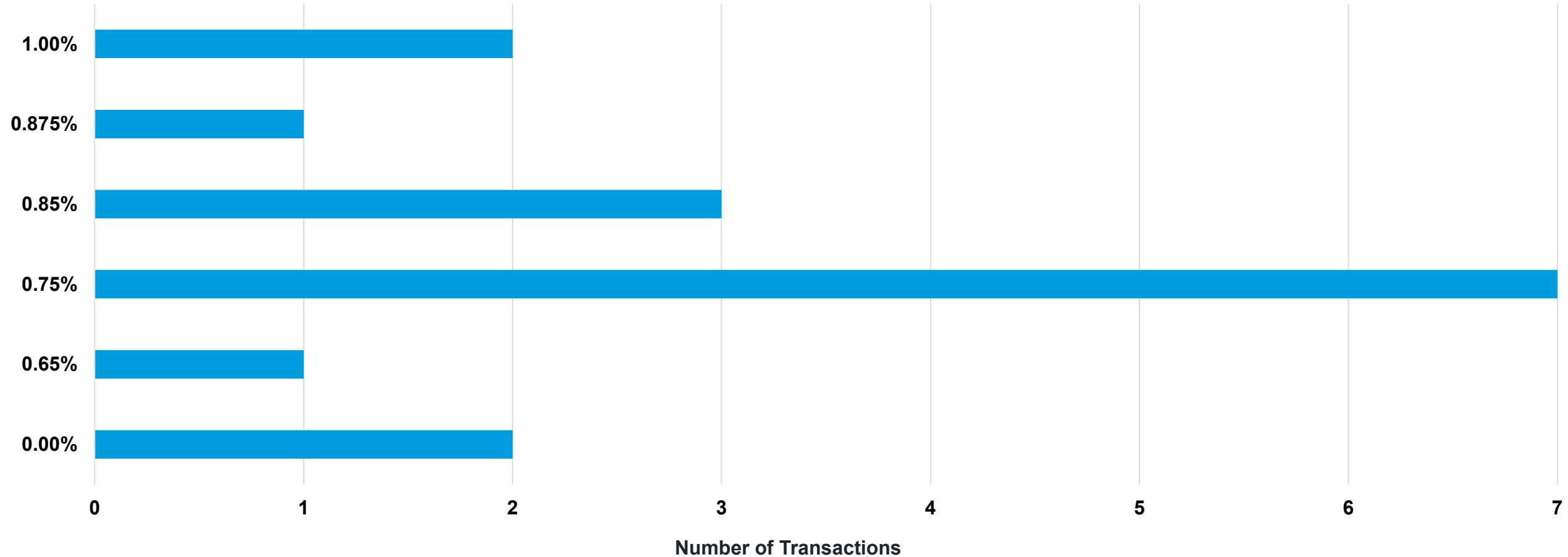


Lead Investor Expense Cap



Lead investor expense caps are often marked at or around half of a continuation fund’s organizational expense cap, so as organizational expense caps have increased, lead investor expense caps have unsurprisingly been on the rise as well.

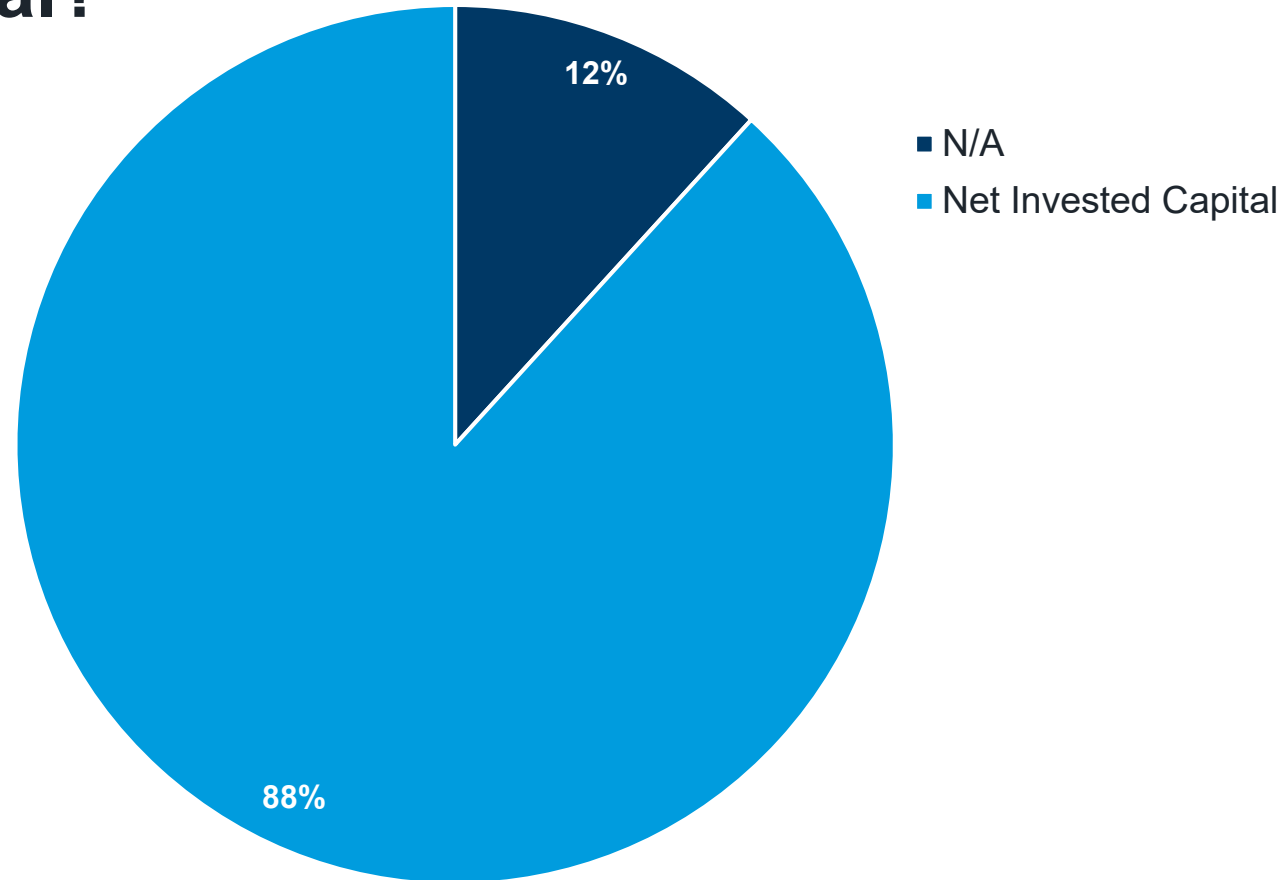
Management Fees During Initial Term



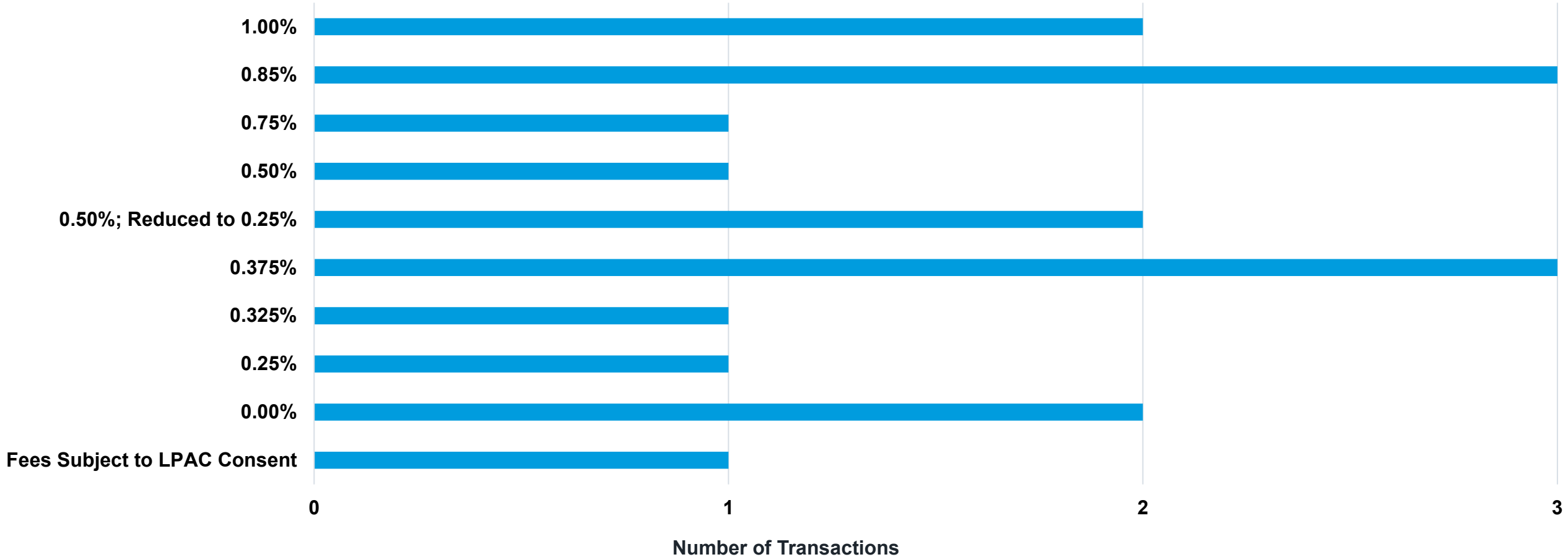
Nearly half of the deals reviewed had management fees at 75 bps during the continuation fund's initial term.

Is Initial Term Fee Amount a Percentage of Net Invested Capital or Committed Capital?

In all of the deals that had a management fee, the rate was a percentage of invested capital rather than committed capital. This is the generally accepted formulation in GP-led transactions.



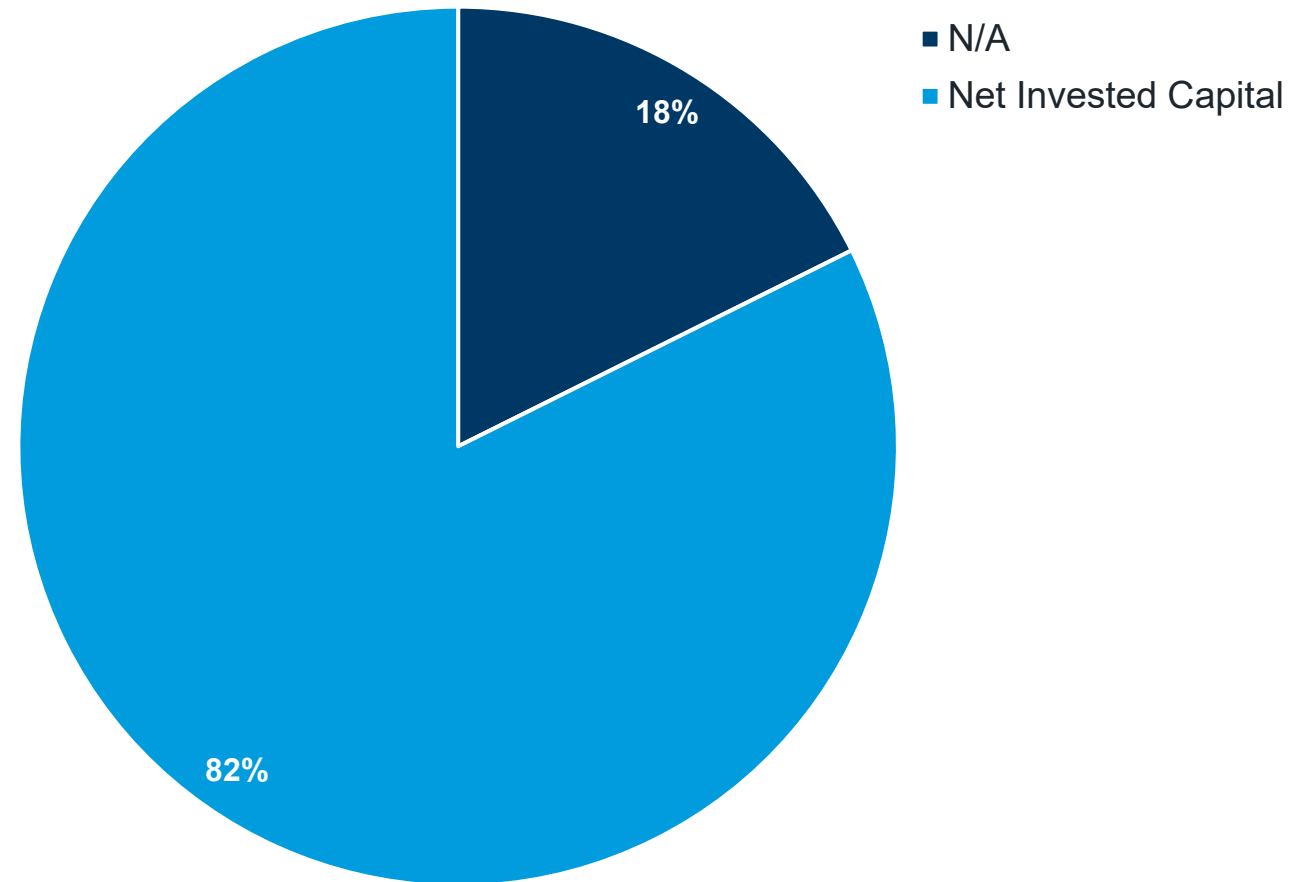
Management Fees for Remaining Term



While not universal, it is common to see a management fee step-down during any term extensions.

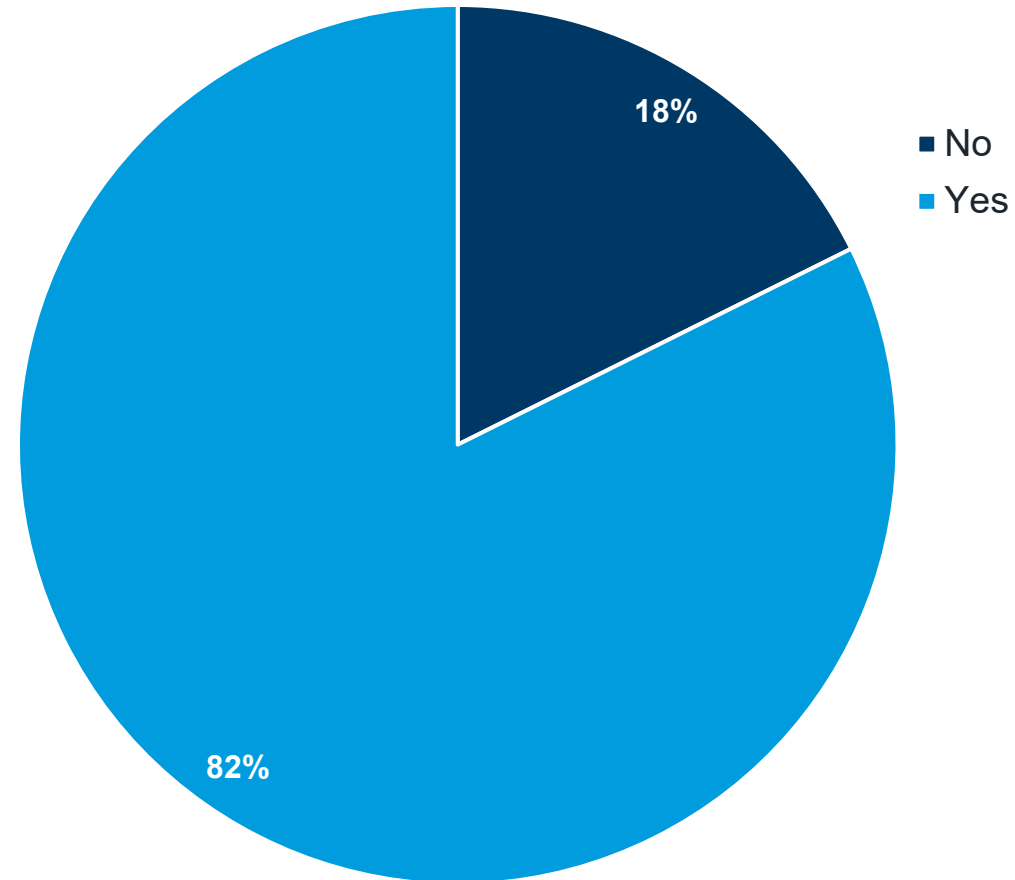
Is Remaining Term Fee Amount a Percentage of Net Invested Capital or Committed Capital?

Like the management fee payable during the initial term, it is standard practice for any step-down rates to be a percentage of invested capital rather than committed capital.



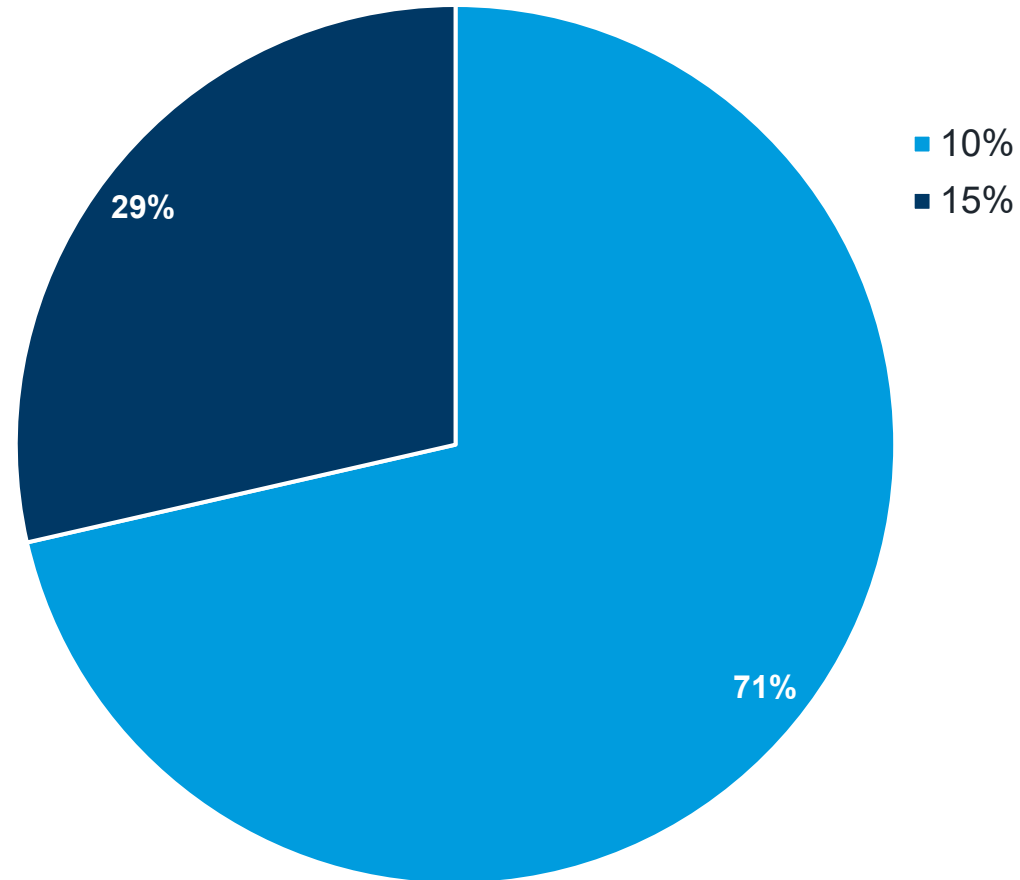
Is There a Carry Ratchet?

Almost all of the deals we worked on in the applicable time period provided for a carry ratchet whereby the carried interest to which the general partner is entitled increases based on generating multiple tiers of returns.



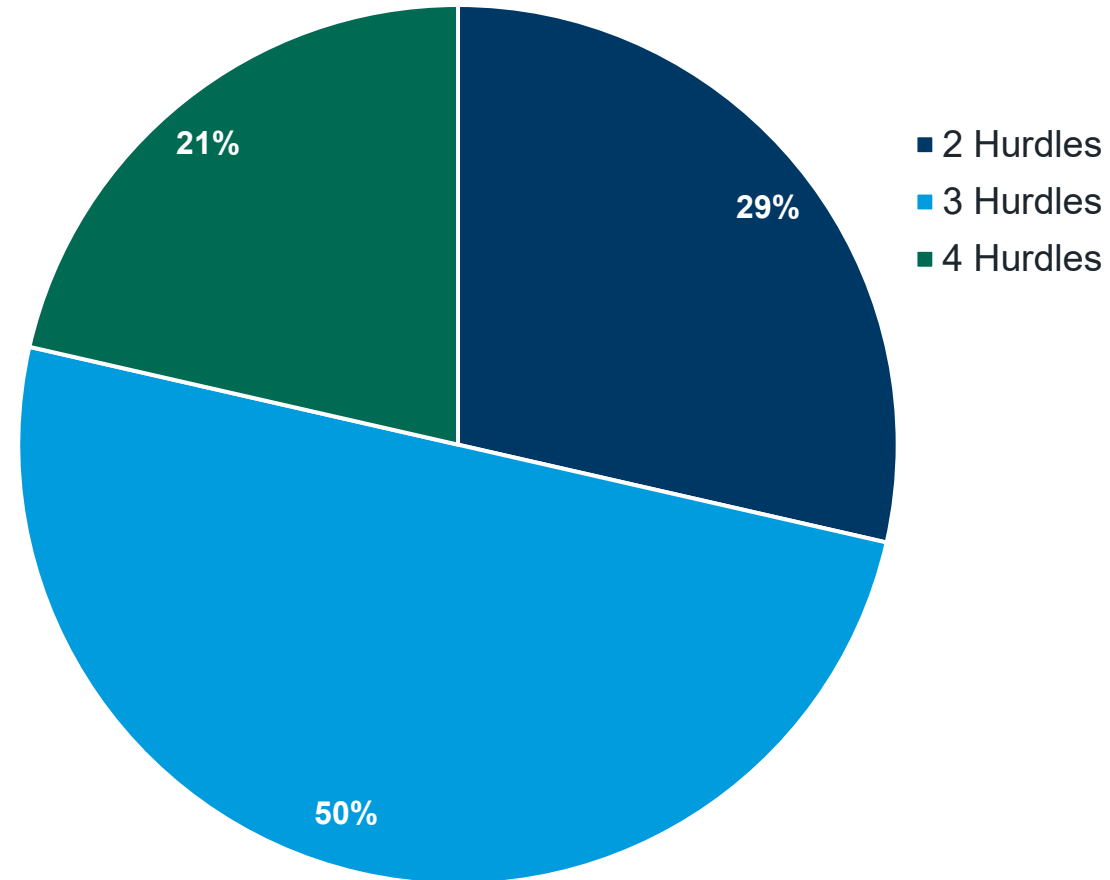
If There Is a Carry Ratchet, What Is the Lowest Attainable Carry Percentage?

10% is the most common first tier of carried interest (71%), with 29% of the deals starting at 15%.



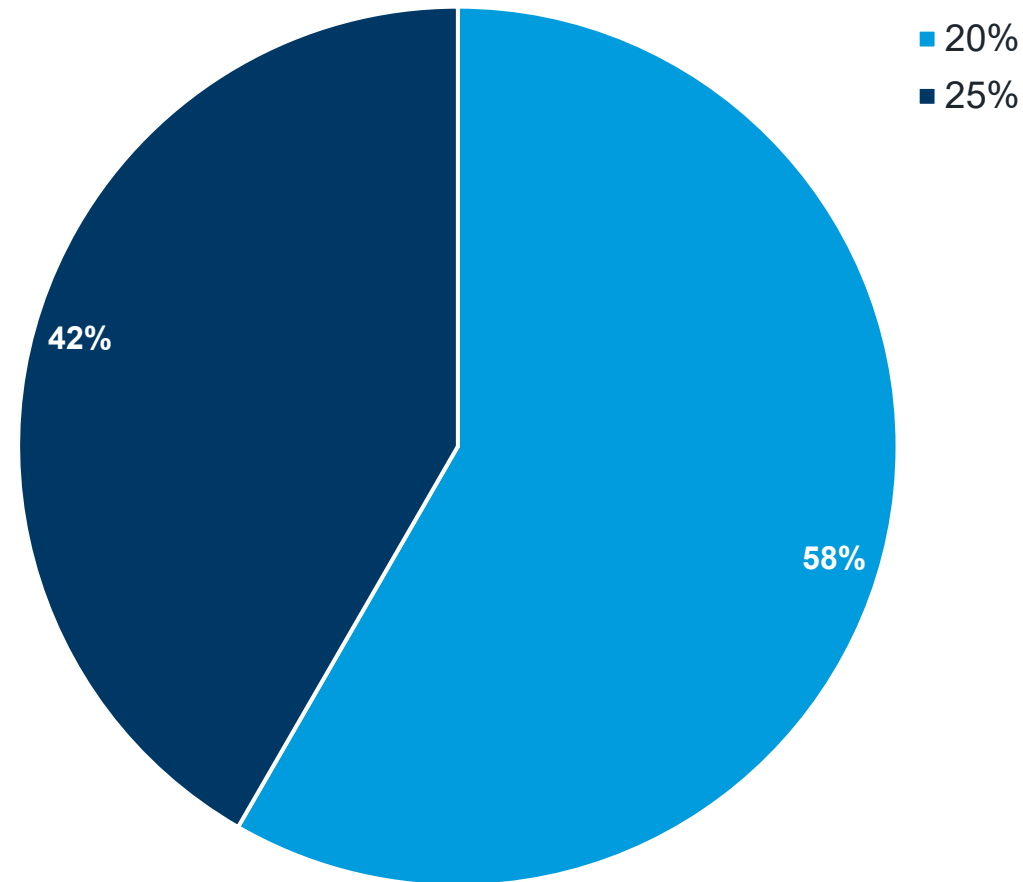
If There Is a Carry Ratchet, How Many Performance Hurdles Are There?

Three hurdles is the most commonly used formulation. We see two and four hurdles less frequently than three with nearly equal consistency.



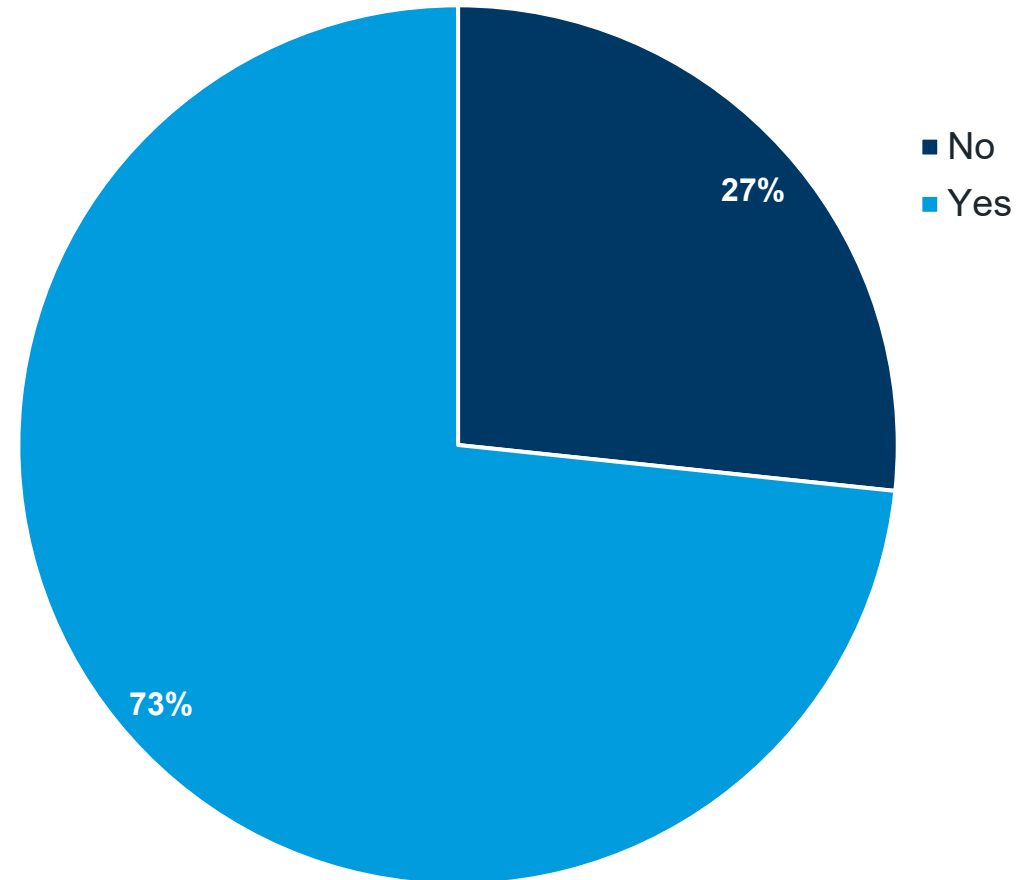
If There Is a Carry Ratchet, What Is the Highest Attainable Carry Percentage once All Hurdles Are Satisfied?

Recent deals have seen the highest attainable carry top out at 20 or 25 percent. This suggests fewer deals where there is a “super carry.”



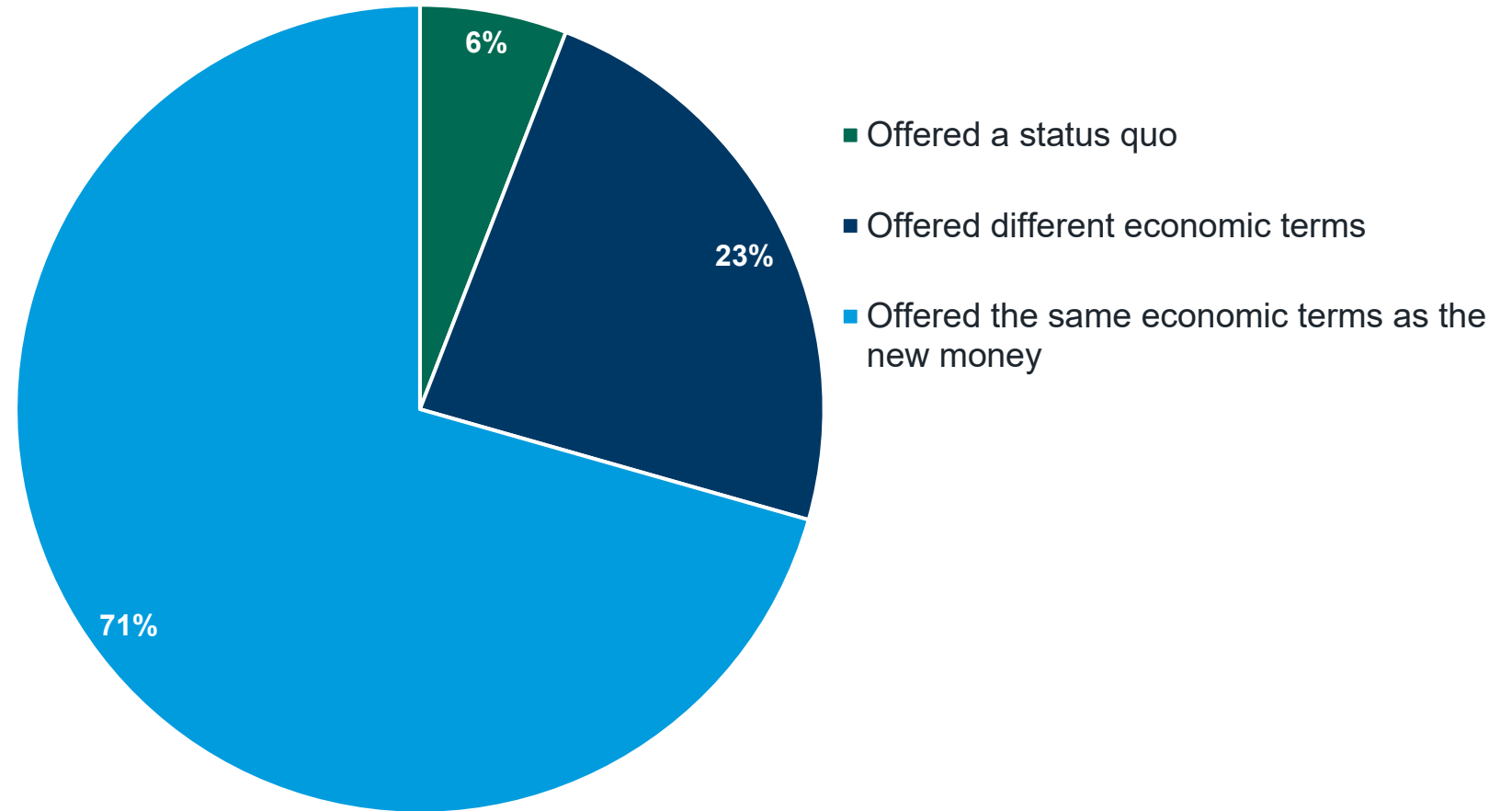
Are Rolling Investors Required to Participate in Follow-Ons?

Recent deals have seen decreased optionality being provided to existing investors, including with respect to requiring rolling LPs to participate in follow-ons alongside new capital.



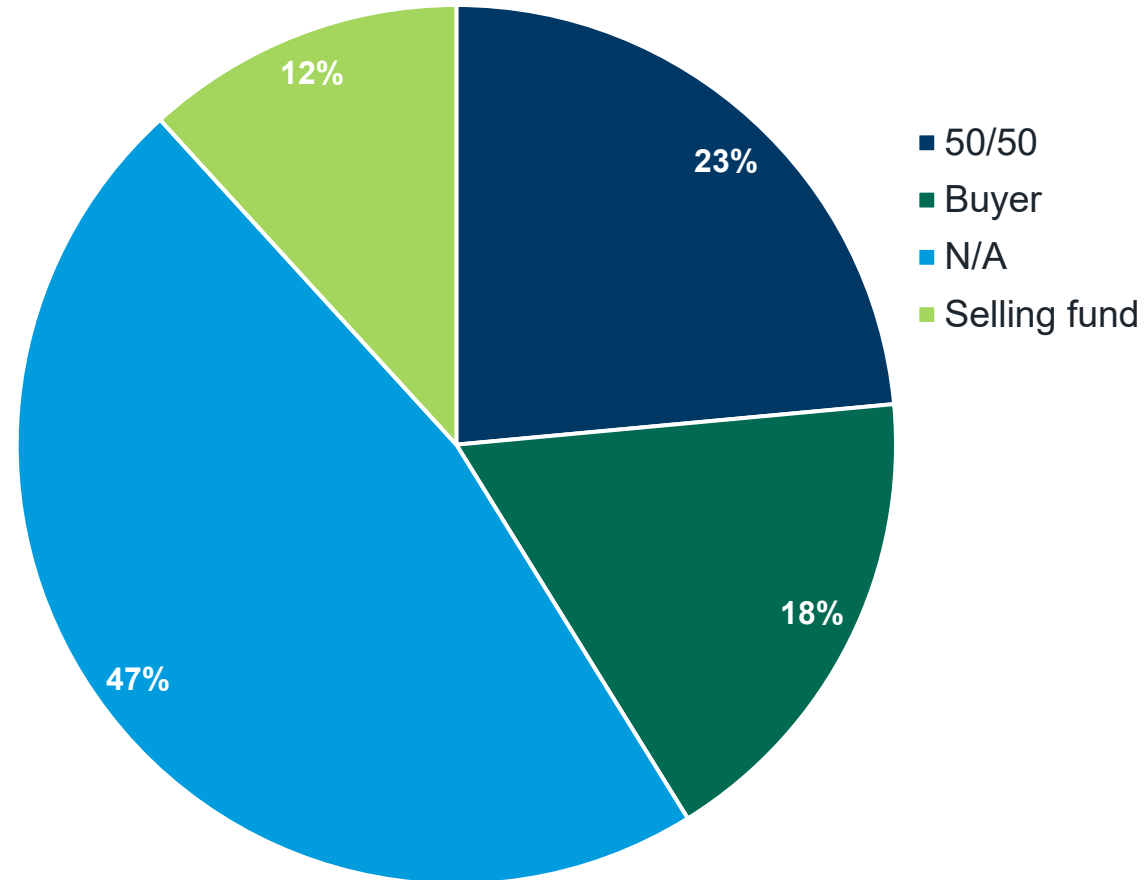
Offerings to Rolling Investors

In line with the prior slide, sponsors have increasingly been requiring rolling LPs to roll on the same economic terms as new investors, with true status quo options being offered with less frequency than in prior years.



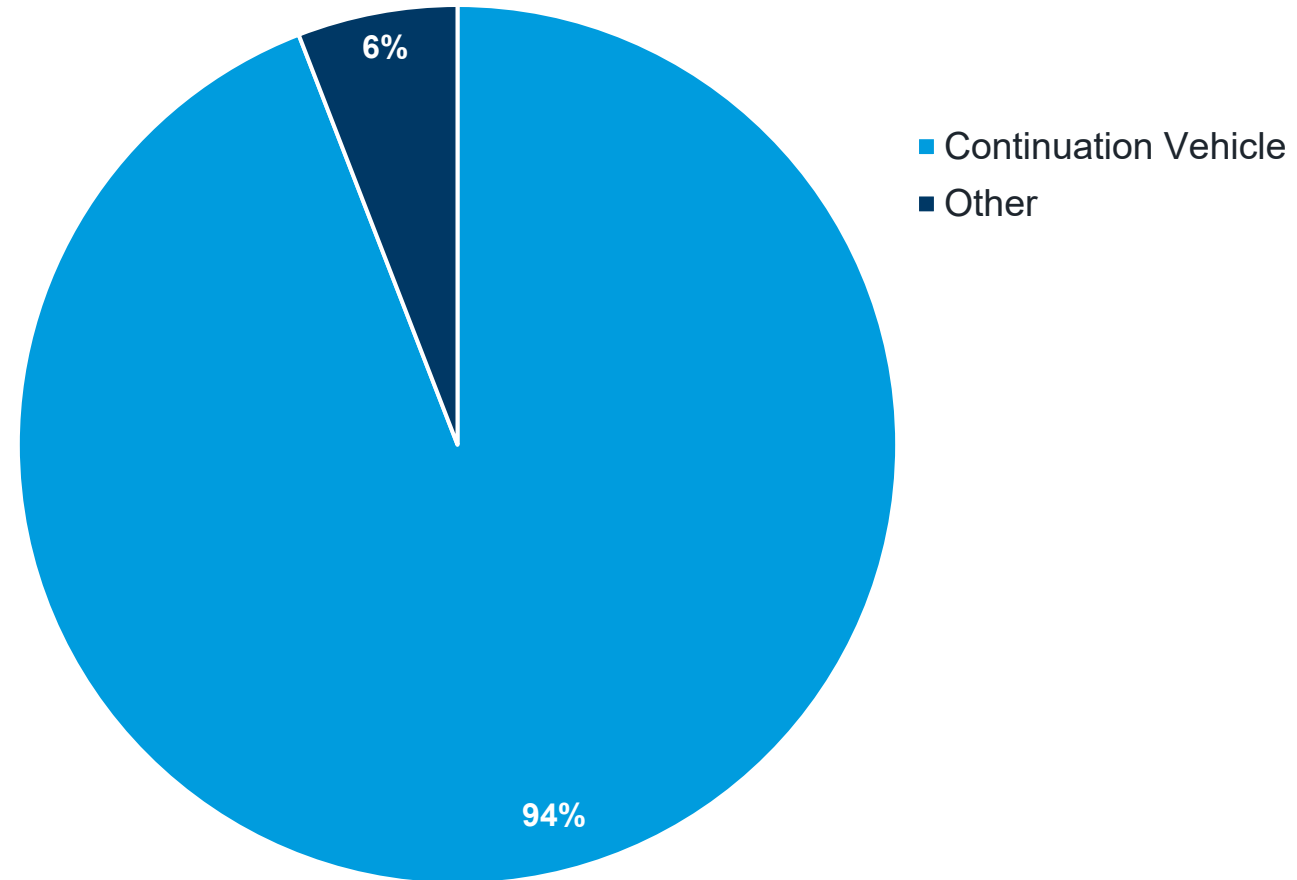
RWI Costs

Almost half of the deals we closed during the relevant time period did not utilize RWI. In those that did, we saw those expenses being allocated in a variety of ways.



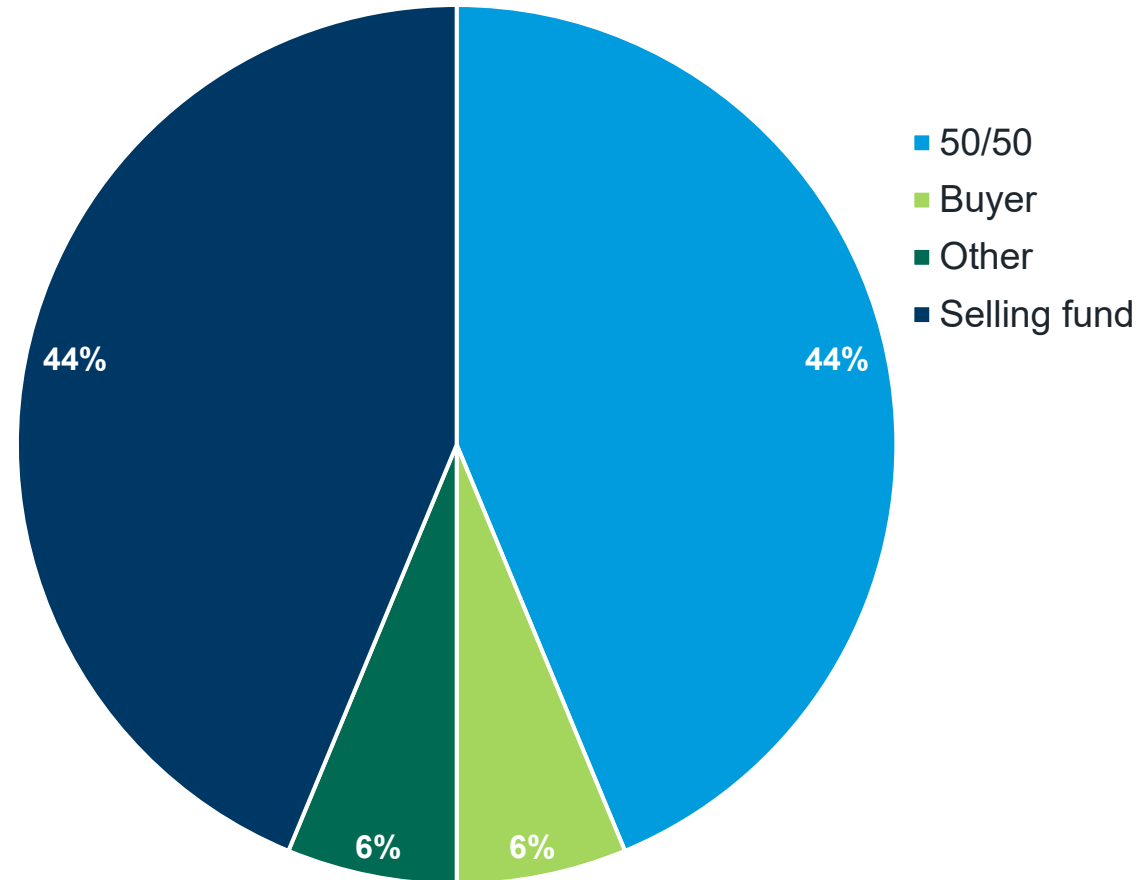
Continuation Fund Organizational Expenses – Who Pays?

Unsurprisingly, the organizational expenses of the continuation fund are generally borne by the continuation fund, subject of course to the caps we saw in an earlier slide.



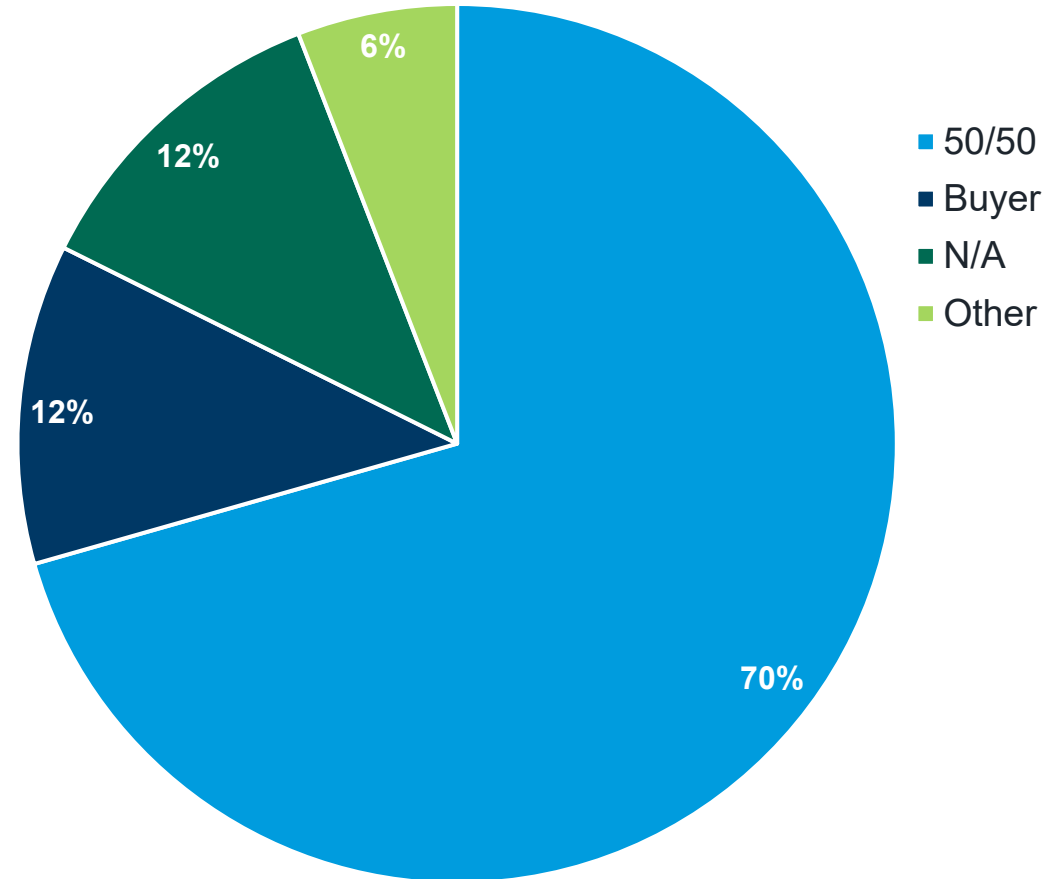
SPA/Contribution Agreement Costs

Recent deals have seen transaction agreement costs being borne either 50/50 between the selling fund and the continuation fund or 100% by the selling fund. This suggests a shift in the market with respect to the allocation of these expenses, which historically were most commonly split 50/50.



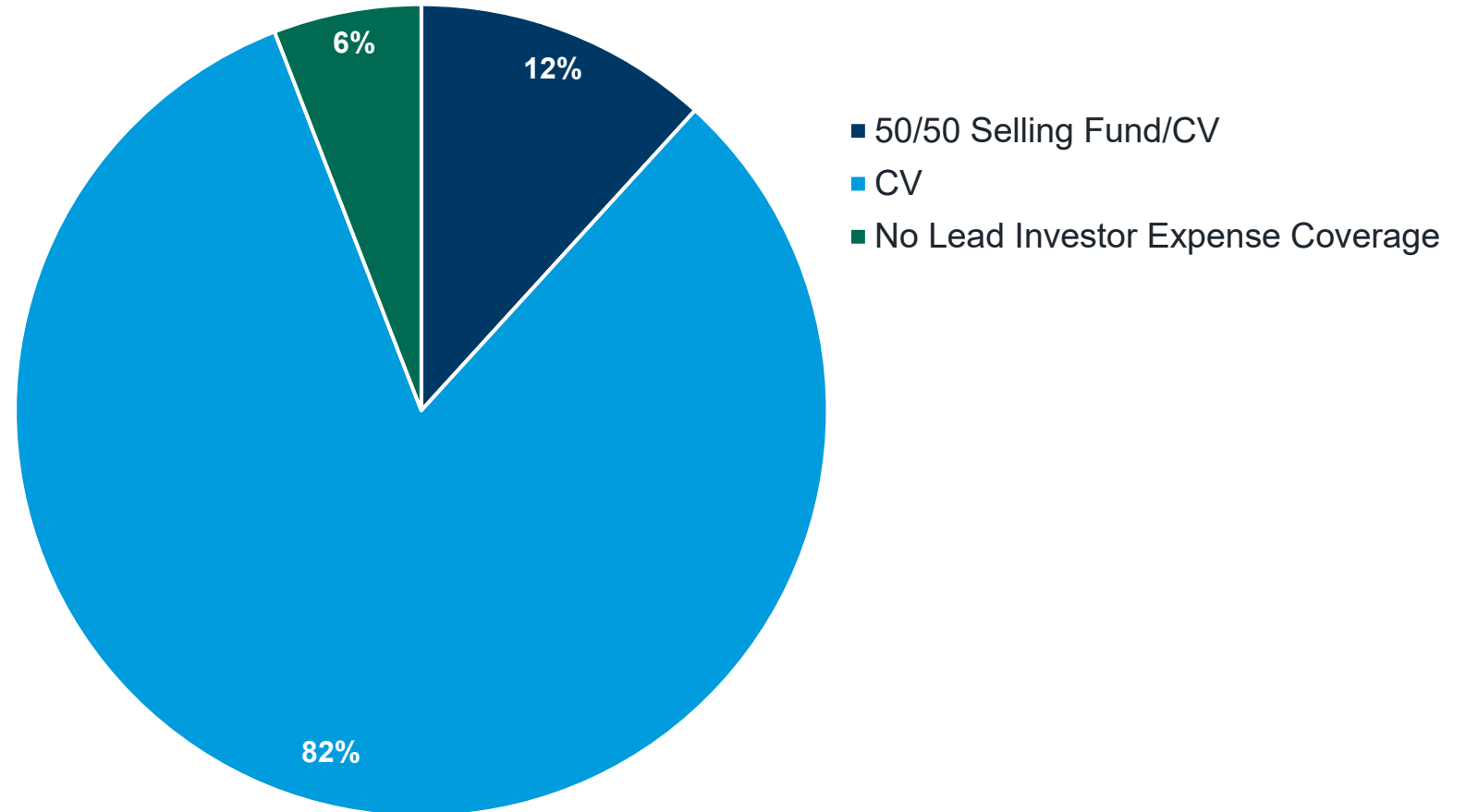
Transfer Taxes

The vast majority of deals continue to split any transfer taxes 50/50 between the parties.



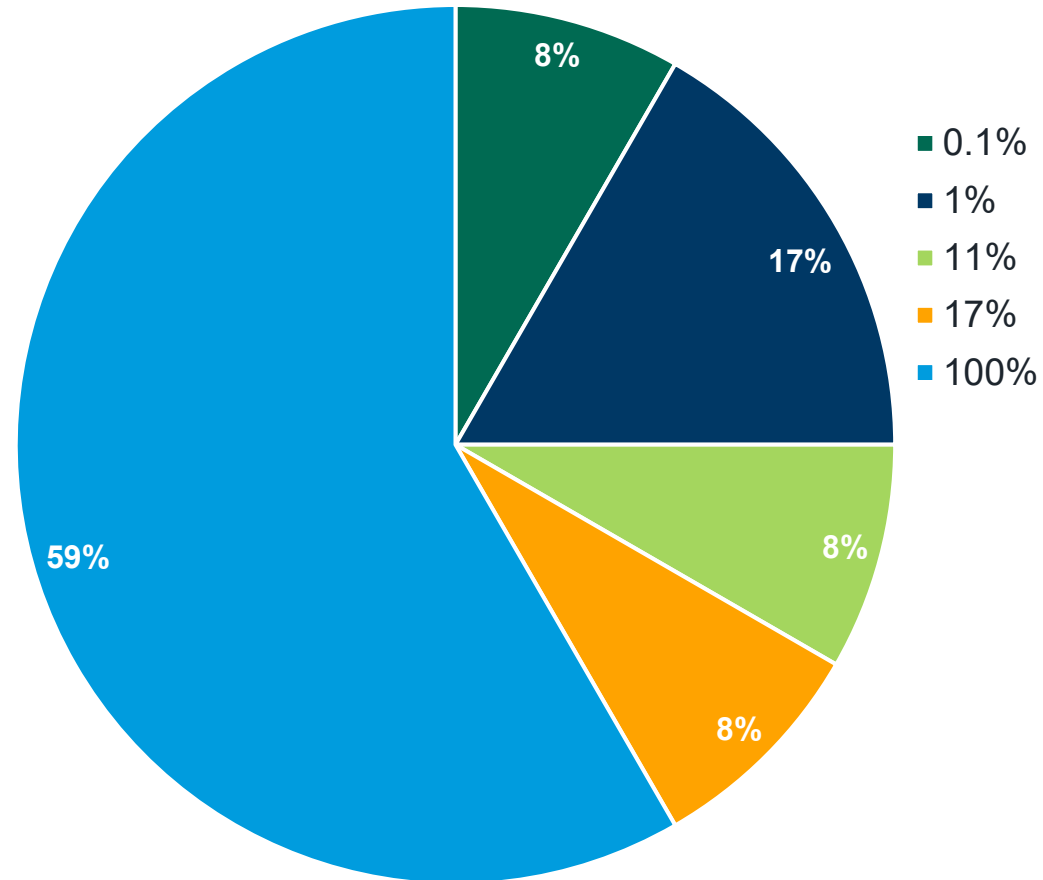
Lead Investor Expenses

The continuation fund most commonly bears lead investor expenses, up to specified caps as seen in an earlier slide. A small minority of deals provide for alternate formulations – either splitting these expenses between the parties, or requiring lead investors to bear all of their own expenses.



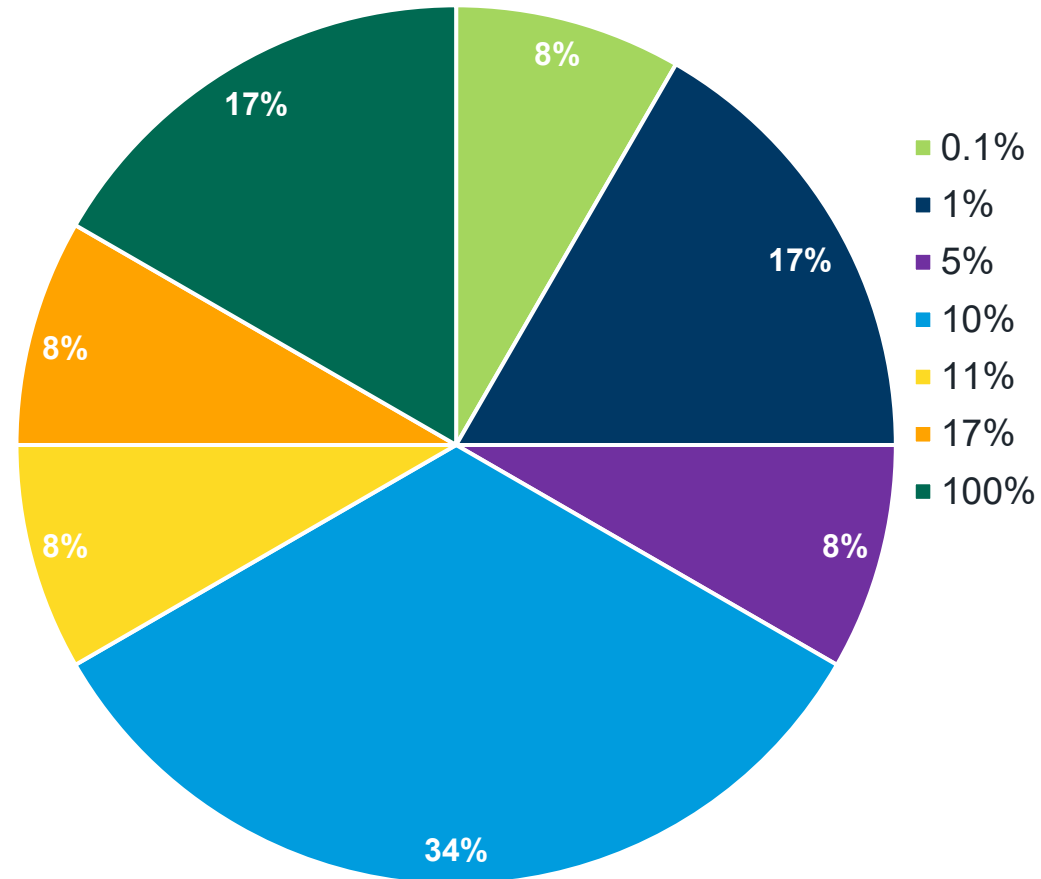
Liability Caps for Fundamental Reps

The majority of the deals we worked on during the relevant time period provided coverage for breaches of fundamental representations up to 100% of the purchase price. Some recent deals still relied on flat dollar amount caps, which account for the other varying percentages reflected on this chart.



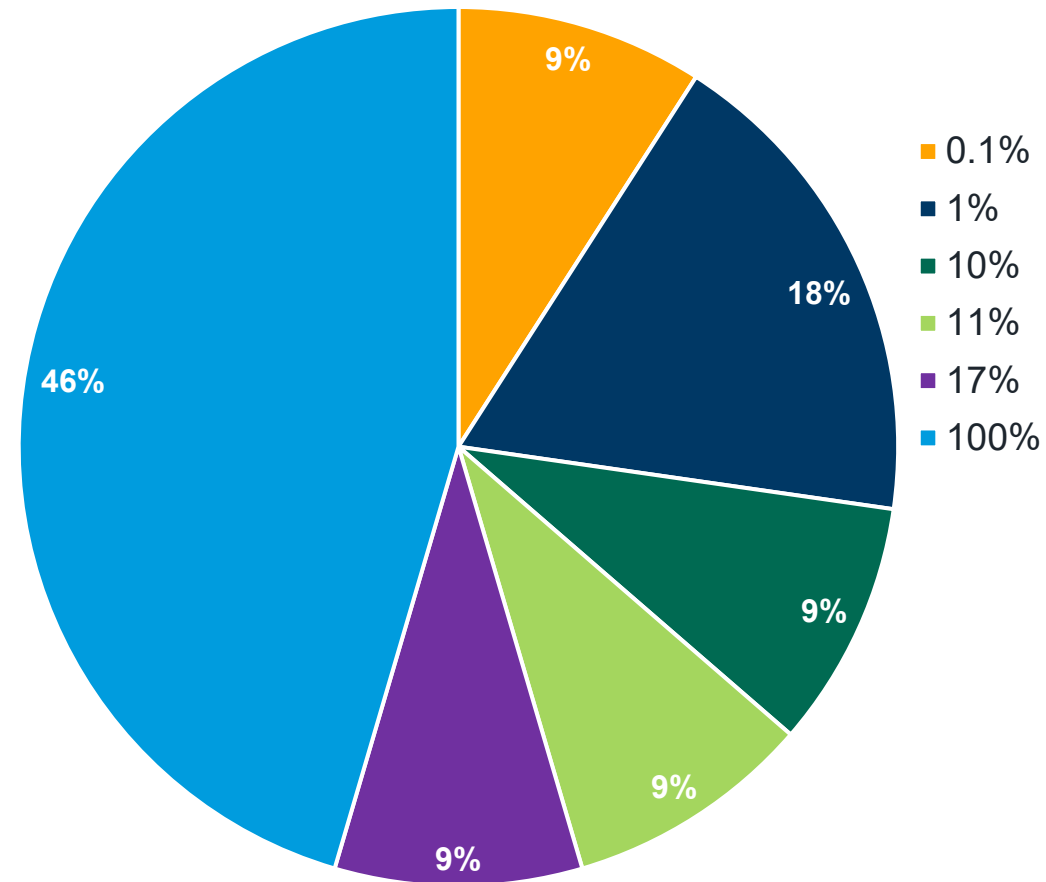
Liability Caps for Non-Fundamental Reps

A wide variety of coverage caps are utilized for breaches of non-fundamental representations. As the use of RWI increases in GP-led deals, indemnity caps and baskets may standardize more.

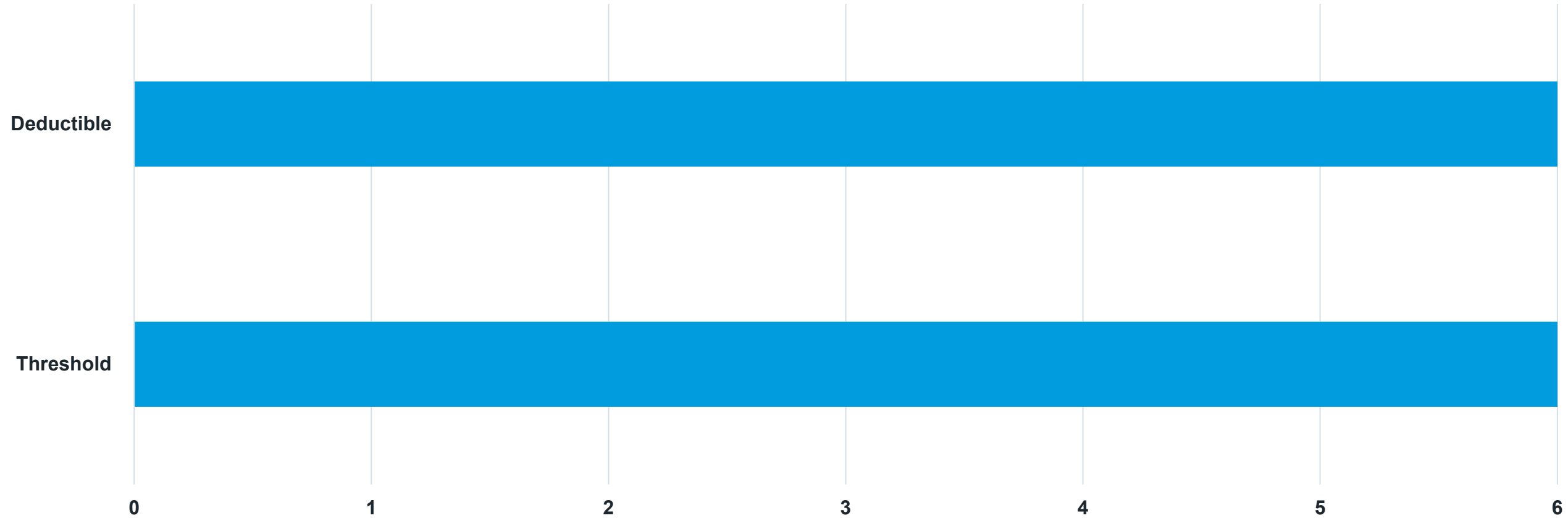


Liability Caps for Excluded Obligations

Nearly half of the deals we closed during the relevant time period provided coverage of up to 100% of the purchase price for Excluded Obligations. This may increase as the use of RWI increases.



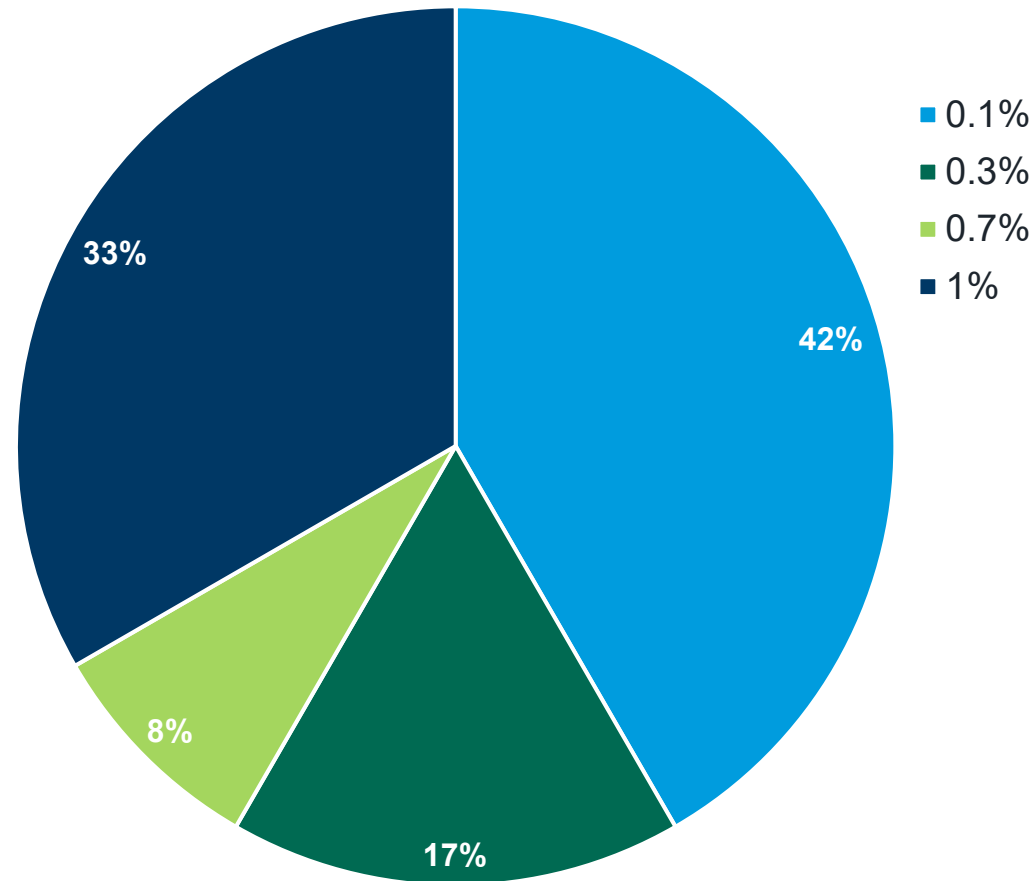
Threshold vs. Deductible



In deals that employed the use of indemnity thresholds or deductibles, each were used with equal frequency. A threshold allows for recovery from dollar one once losses exceed a specified amount, while recovery is limited to amounts in excess of a deductible.

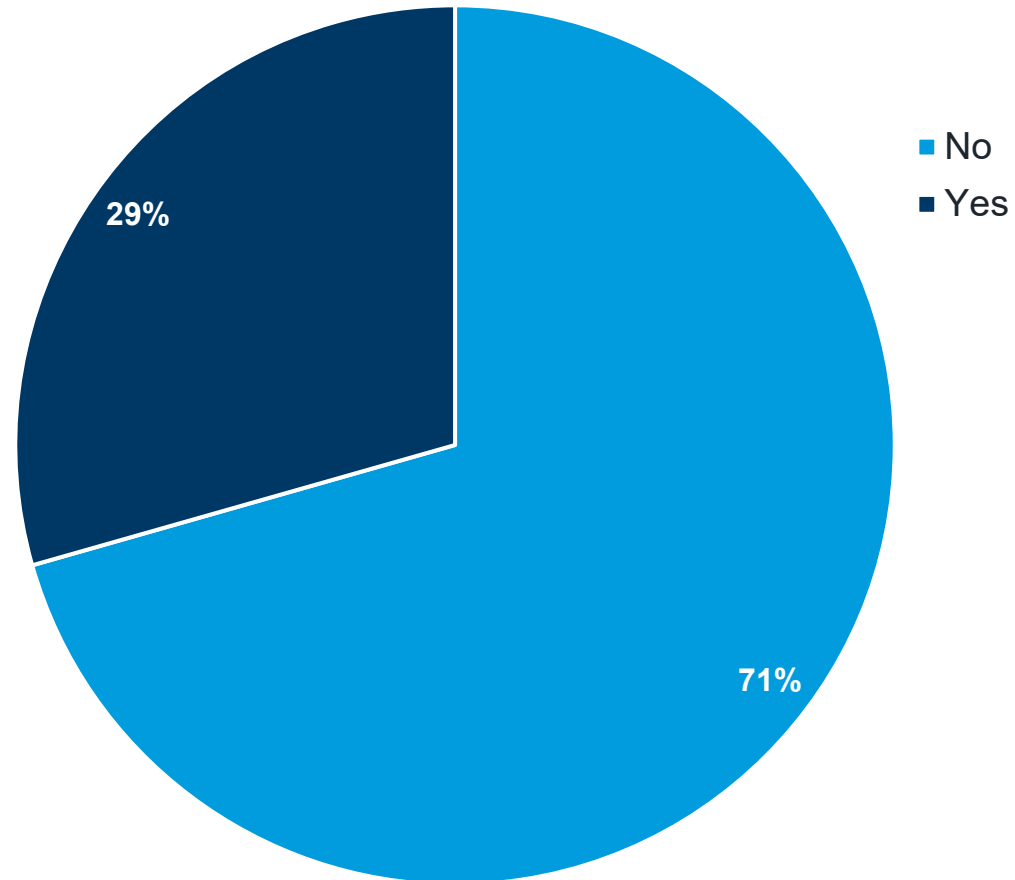
Percent of Threshold/Deductible

Thresholds and deductibles are generally a small dollar amount or percentage relative to overall deal value, with deductibles typically being the lower of the two.



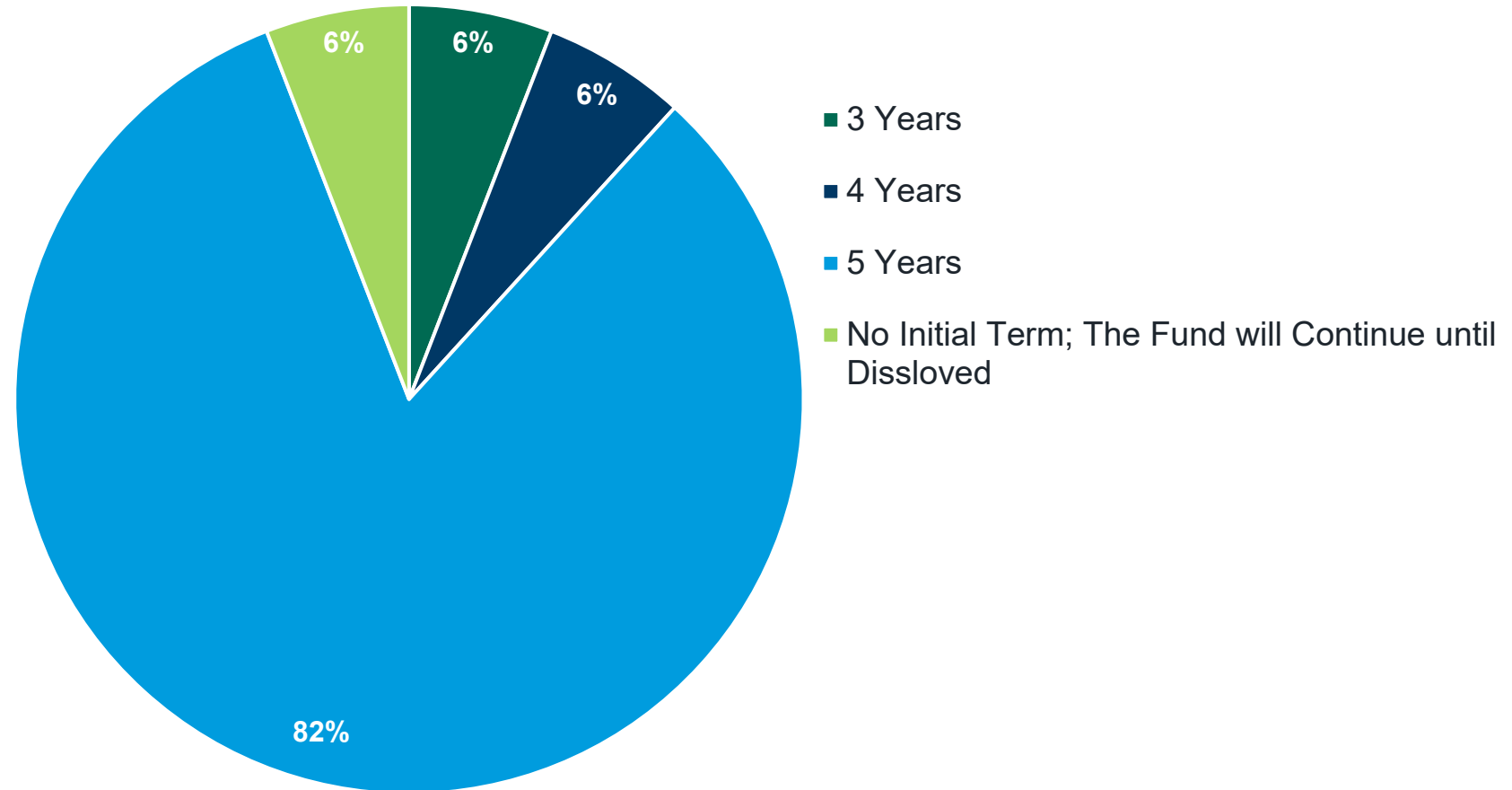
Does the GP/Manager Provide Reps/Warranties?

GP/Manager reps and warranties were made in 29% of deals closed in the relevant time period. These reps have become a less critical element of the deal.



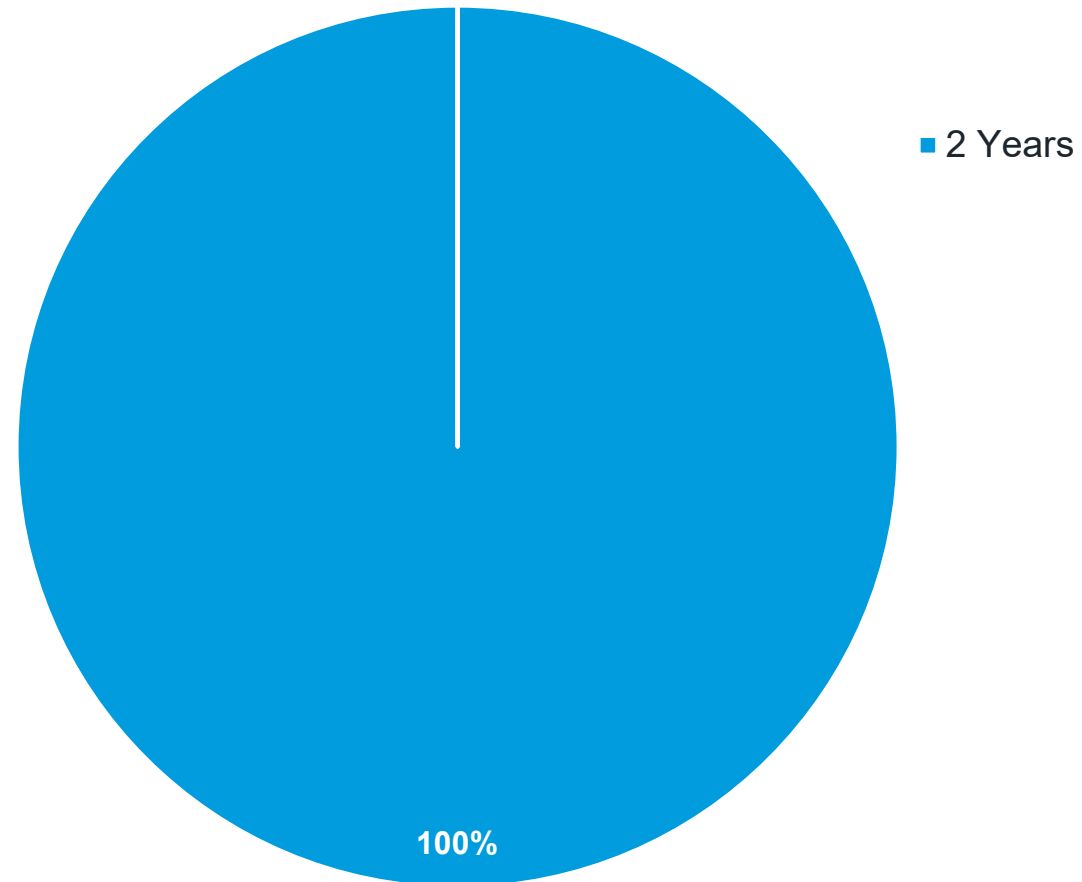
What Is the Initial Term of the Continuation Vehicle?

Nearly all continuation funds closed during the relevant period had an initial term of five years from the transaction closing date.



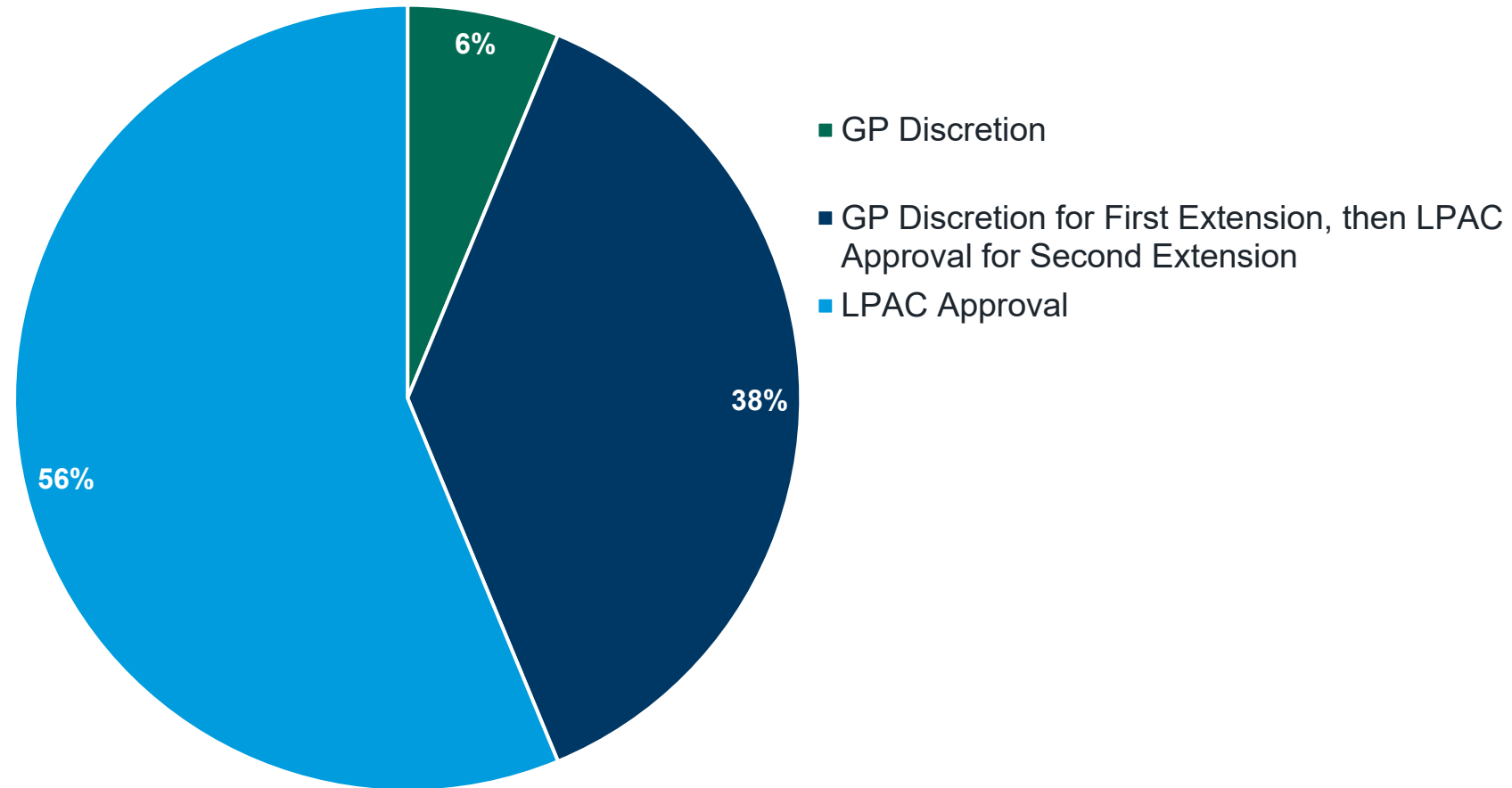
If Term Extensions Are Permitted, What Are the Lengths of Such Extensions?

Two consecutive one-year extensions have become the market standard for continuation funds.



If Term Extensions Are Permitted, What Consent Is Required for Such Extensions?

These term extensions are permitted with some combination of GP discretion and LPAC approval, with LPAC approval being required for at least the second one-year extension in almost all instances.



Navigating Liquidity: Proskauer's Secondaries Pulse Check



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