

# Managing Liquidity through General Partner-Led Secondaries

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## ARTICLE SUMMARY

- GP-leds (secondary transactions led by General Partners as opposed to Limited Partners) are incredibly common today across venture capital and private equity funds
- There is a robust spectrum of structures for managers to consider, depending upon the key goals of the transaction, that go beyond the typical continuation fund (a new entity formed with the purpose of acquiring one or more assets from an original investment fund)
- The included diagrams offer a starting point for internal assessment, but the most effective and efficient solutions will be custom designed based on the circumstances of the potential transaction

## The Rise of the GP-Led Market

Like other aspects of venture capital, GP-led secondary deals initially gained popularity in more traditional buyout funds before expanding throughout the broader private equity asset class. Indeed, GP-led transactions have become so frequent that an estimated 42% of the \$120B+ expected in secondary transaction volume in 2022 will come through GPs, up from only 24% just five years prior in 2017.<sup>1</sup> The vast majority of these secondary transactions undoubtedly still occur in the larger buyout asset class, though there has recently been a notable shift in market perception of GP-led deals for smaller tech buyout and venture capital fund managers.<sup>2</sup>

## Annual Secondary Transaction Volume (\$B)<sup>1</sup>



Source: Jefferies LLC

<sup>1</sup> "1H 2022 Global Secondary Market Review". Jefferies LLC. July 2022.

<sup>2</sup> "Sponsor-Led Secondary Market Report H1'22". Lazard Private Capital Advisory. August 2022.

Many private equity managers across buyout and venture funds today often seek to retain ownership in their top-prospect companies through GP-leds, rather than sell their high-quality assets to competing funds. In fact, many traditional buyout fund managers like [Blackstone](#), [Carlyle](#), [CVC](#), and [Ares](#) have acquired secondary fund managers in the last decade or built out internal secondary teams, bringing this capability in-house and unlocking assets that might otherwise be difficult to access.<sup>3,4,5,6</sup> The increased attention to secondary investment strategies has been emulated by venture capital managers as well, and it is increasingly common for many of the ecosystem's most coveted private companies to change ownership indirectly—through derivative transactions that do not impact an operating company the way public listings, M&As, or control buyouts do.

While GP-led transactions may have historically been associated with GPs seeking last-resort liquidity or distressed funds in need of restructuring, today they represent a practical liquidity option to provide investor relations support for existing LPs. Further, GP-led transactions are no longer solely pertinent to tail-end funds (defined as a fund whose original term has ended). Though liquidity considerations certainly arise more often later in a fund's life, facilitating a GP-led transaction can also be a sign of prudent fund management. Several structures help a GP realize gains and crystallize carry if a portfolio has had one or several unrealized winners, often while allowing LPs to retain upside potential if interested.

When executed correctly, GP-led deals can be beneficial for all parties involved:

- **General Partner:** Unlock a new liquidity path while retaining asset control if desired; forge new relationships while bolstering existing relationships via options for proceeds generation
- **Limited Partners:** Receive liquidity if needed when organic portfolio realizations may be sparse or delayed; or in certain transaction types, preserve optionality by rolling economic interest
- **Portfolio Companies:** Remove any unnatural pressure for a liquidity event stemming from Board directors needing to harvest investments at the tail-end of their fund's life
- **New Investors:** Risk-mitigated access to high quality assets through strong GP alignment, with reduced blind pool risk and an accelerated path to investment realization

Before embarking upon any secondary transaction, a GP should start with an honest assessment of their goals. Is the transaction strictly to optimize proceeds? Is there a new fundraise on the horizon? Are there limited resources or new endeavors taking attention? Is there an internal push for liquidity or is the demand pulled in from LPs? Does a single investor want liquidity or the entire partnership? Is the fund out of extensions or still in its investment period? Could the portfolio benefit from a longer hold time? GP-led deals can take many forms, so starting to answer these questions will help narrow down options for the right structure, partner, and approach.

## Types of GP-Led Secondary Transactions

Industry Ventures has been active in the venture secondary market for over two decades and invested across numerous transaction types—including direct cap table transfers, LP or GP interest purchases, portfolio acquisitions, using special purpose vehicles, and many more structures. The table below provides a summary of the most common deal situations the firm has encountered which often catalyze GP-led secondary transactions.

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<sup>3</sup> "Blackstone closes acquisition of Strategic Partners from Credit Suisse". Private Banker International. August 2013.

<sup>4</sup> "APG and PGGM Agree to Sell AlInvest Partners to The Carlyle Group and AlInvest Management". The Carlyle Group. January 2011.

<sup>5</sup> "British Buyout Firm CVC to Acquire Glendower Capital". Reuters. September 2021.

<sup>6</sup> "Ares Management Corporation Completes Acquisition of Landmark Partners". Business Wire. June 2021.

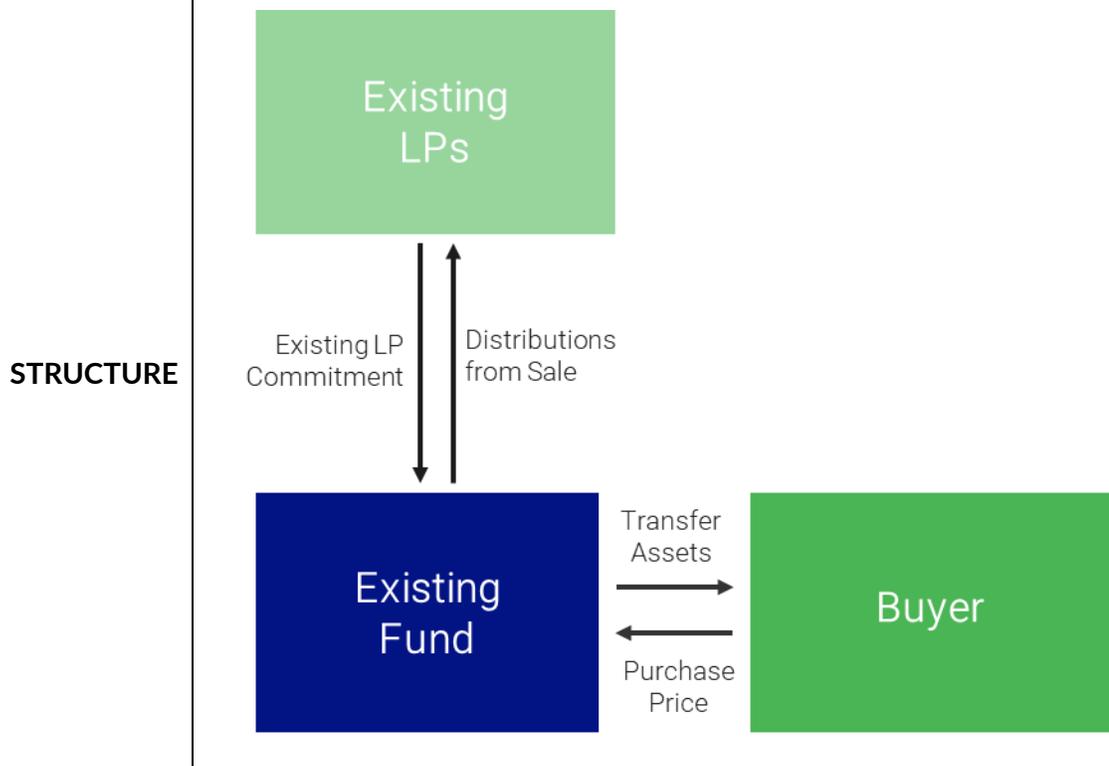
Assets Transferred to New Vehicle	Asset Sale / Wind Down	<ul style="list-style-type: none"> <li>• Fund entering wind down sells final assets, removes burden for future audits and reporting</li> <li>• Direct transfer of assets to buyer with no new vehicle created</li> </ul>
	Continuation Vehicle	<ul style="list-style-type: none"> <li>• Transfer of single, multiple, or all assets to new vehicle with reset economics</li> <li>• LPs have option for liquidity or rollover, giving assets more time to capture upside</li> </ul>
	Strip Sale (Cont. Vehicle)	<ul style="list-style-type: none"> <li>• A type of continuation vehicle where the fund partially sells a percent of all or some assets</li> <li>• GP manages both existing and sold strip in new vehicle; existing LPs retain upside</li> </ul>
Assets Retained by Existing Fund	LPA Amendment	<ul style="list-style-type: none"> <li>• Amend LPA to extend fund or reset economics, giving assets more time to capture upside</li> <li>• Requires LP approval, which may be facilitated after stand-alone LP interest secondaries</li> </ul>
	LP Tender / Co-Sale	<ul style="list-style-type: none"> <li>• New investor offers to buy interests from existing LPs at agreed to price</li> <li>• No new vehicle required, with secondary buyer assuming ownership of existing commitments</li> </ul>
	Preferred LP Commitment	<ul style="list-style-type: none"> <li>• LP provides new capital with preferred return for fund management or distribution to LPs</li> <li>• Requires LPAC approval/amendment to create separate LP class for preferred commitment</li> </ul>

For illustrative grouping, the blue rows represent a transfer in asset title to a new buyer or entity (i.e. there will be a change on the portfolio company capitalization tables), whereas the green rows represent a transfer in fund-level ownership without moving assets out of the existing fund (i.e. no changes to portfolio company capitalization tables). As one specific callout, an LPA amendment is a standard fund governance practice and not typically associated with any secondary transaction. In certain situations, though, a GP might aim to coordinate an LP interest secondary to facilitate support for a proposed amendment. Also note that this article solely discusses the commercial aspects of GP-led secondaries, and each transaction type will have its own tax and accounting implications. Sellers and funds alike should enlist appropriate advisors when considering such implications.

We will review these transaction types from a more technical lens, but there is clearly a robust spectrum of options to consider—from narrow to broad in scope, simple to complex in structure, one or many sellers, single or multi-asset, etc. In practice, there is a large set of potential permutations when it comes to GP-led transactions, based on how the manager answers the questions above. The overviews below offer a starting point for internal assessment, but a bespoke solution will be most effective and efficient based on the circumstances and goals of the General Partner.

## Asset Sales & Fund Wind-Downs (Assets Transferred)

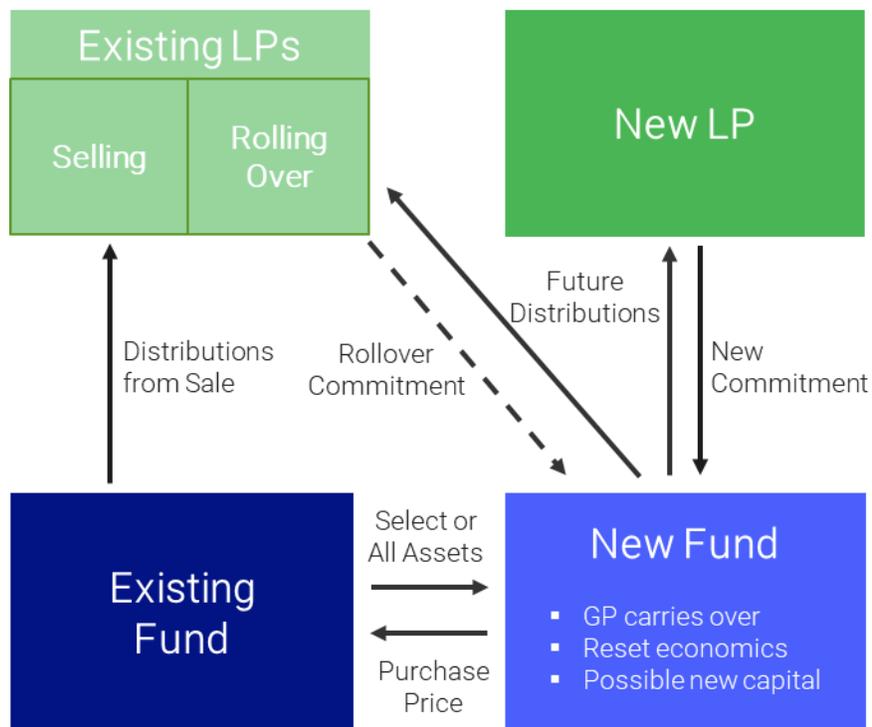
<b>SITUATION</b>	A fund needs to wind down, but there is not an imminent exit for the remaining portfolio assets
<b>SOLUTION</b>	GP finds a buyer for the remaining asset(s) in the fund, allowing the fund to fully liquidate; assets are transferred directly to buyer(s)
<b>MERITS</b>	<ul style="list-style-type: none"><li>▪ Enables fund wind-down, removes burden of future audit expenses and reporting requirements</li><li>▪ No new vehicle creation or associated costs as buyer takes over assets directly</li></ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"><li>▪ Limited upside potential for interested LPs once assets have been sold</li><li>▪ Need to find a knowledgeable counterparty with experience effecting required transfers to close the deal</li></ul>



## Continuation Vehicle – Single or Multi-Asset (Assets Transferred)

<b>SITUATION</b>	Tail-end fund has remaining assets that need time to achieve full upside potential and has LPs seeking near-term liquidity
<b>SOLUTION</b>	Transfer assets into new entity managed by the GP, with the option for existing LPs to roll existing interests into new entity <ul style="list-style-type: none"> <li>▪ GP resets economics and possibly receives primary capital for follow-ons</li> <li>▪ May include full portfolio or a subset</li> </ul>
<b>MERITS</b>	<ul style="list-style-type: none"> <li>▪ GP stays involved with portfolio while possibly crystallizing carry in the prior vehicle</li> <li>▪ LPs who roll can capture gains from future upside</li> <li>▪ Existing portfolio valued by third party to avoid conflicts</li> </ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"> <li>▪ Rolling LPs may not be amenable to paying new economics in the new vehicle (could honor status quo)</li> <li>▪ Moving title into an affiliate vehicle may require LPAC review</li> <li>▪ Certain attributes could trigger ERISA or SEC registration</li> </ul>

### STRUCTURE



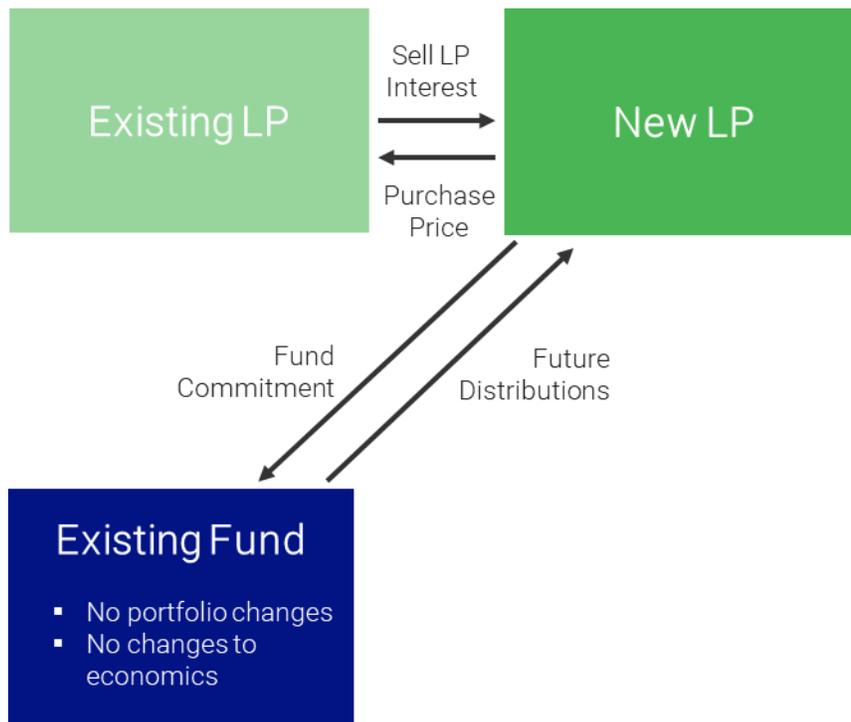
## Continuation Vehicle – Strip Sale (Assets Transferred)

<b>SITUATION</b>	GP wants to harvest unrealized value or provide LPs with DPI by selling a specific percentage of the portfolio while substantially retaining upside potential
<b>SOLUTION</b>	<p>Transfer a percentage of each asset into new entity managed by the GP</p> <ul style="list-style-type: none"> <li>Current GP may negotiate reset carried interest and/or management fee in new fund</li> </ul>
<b>MERITS</b>	<ul style="list-style-type: none"> <li>GP stays involved with portfolio and any Board seats while generating DPI and possibly crystallizing carry in the original fund</li> <li>Helps de-risk a fund from concentrations in companies or sectors</li> <li>LPs receive a distribution today and retain portion of the upside for tomorrow</li> </ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"> <li>Complexities that may arise around cross-fund management</li> <li>Transferring title into an affiliate vehicle may require LPAC review</li> <li>Certain attributes could trigger ERISA or SEC registration</li> </ul>
<b>STRUCTURE</b>	<p>The diagram illustrates the structure of a strip sale. At the bottom left is the <b>Existing Fund</b> (dark blue box). A hatched section at the top of this box is labeled "Specific Percent of Fund". An arrow labeled "Strip" of Assets points from this section to the <b>New Fund</b> (blue box) on the bottom right. A return arrow labeled "Purchase Price" points from the New Fund back to the Existing Fund. The New Fund box contains a list: "GP carries over", "Reset economics", and "Possible new capital". Above the Existing Fund is a light green box for <b>Existing LPs</b>. An upward arrow labeled "Distributions from Strip Sale and Future Proceeds" points from the Existing Fund to Existing LPs. Above the New Fund is a dark green box for <b>New LP(s)</b>. A downward arrow labeled "New Commitment" points from New LP(s) to the New Fund. An upward arrow labeled "Percent of Future Proceeds Purchased in Strip" points from the New Fund to New LP(s).</p>

## LP Interest Secondary (Not A GP-Led, For Reference Only)

<b>SITUATION</b>	Limited Partner seeking liquidity <a href="#">for any of various possible reasons</a> on a single fund interest or portfolio of interests
<b>SOLUTION</b>	LP sells the capital account to a new buyer <ul style="list-style-type: none"><li>▪ No changes to portfolio holdings; no changes to economics or terms of fund</li><li>▪ <b>Though a GP could introduce possible buyers, LP interest secondaries are typically “LP-led” transactions</b></li></ul>
<b>MERITS</b>	<ul style="list-style-type: none"><li>▪ Minimal involvement by the GP or impact on any other existing LPs</li><li>▪ Efficient: individual solution for individual situation</li></ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"><li>▪ May not solve other issues for the GP (e.g. longer fund life, reset economics, track record realizations, etc.)</li><li>▪ <a href="#">Suitable buyer should be found</a> to ensure long-term reliable capital partner with experience effectively executing similar purchases</li></ul>

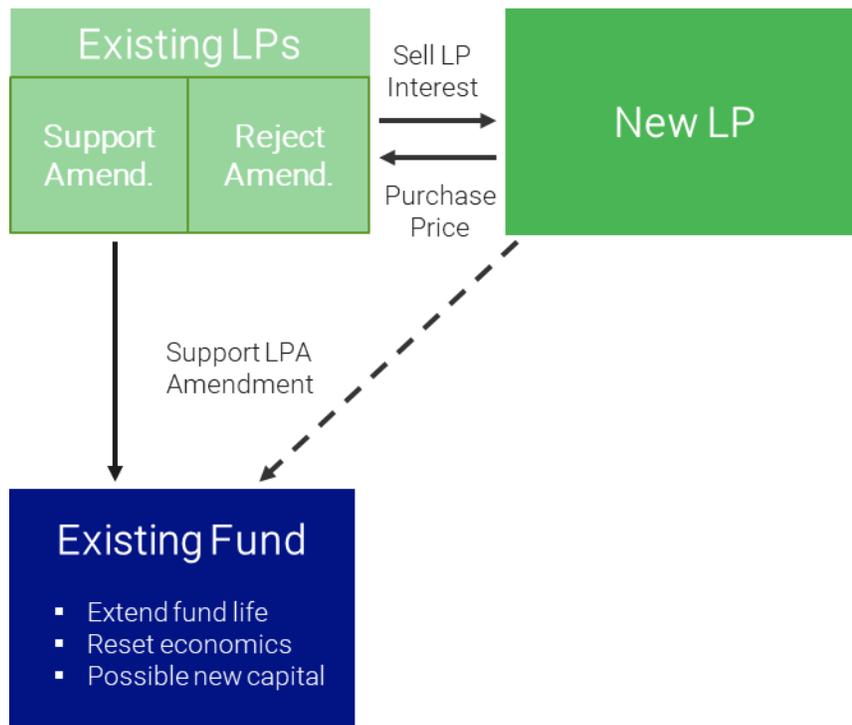
### STRUCTURE



## LPA Amendment (Not A GP-Led, For Reference Only)

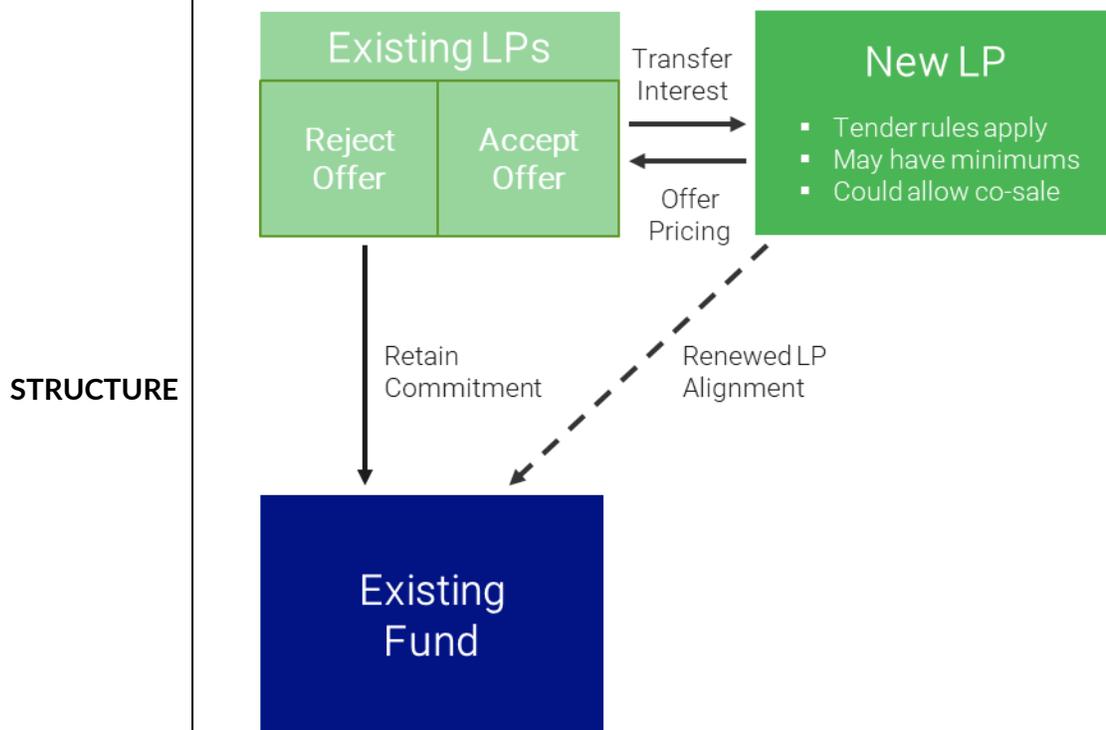
<b>SITUATION</b>	Fund approaching the end of its term needs additional time for assets to mature or needs re-incentivized manager
<b>SOLUTION</b>	Amend LPA to extend fund life or reset economics <ul style="list-style-type: none"><li>▪ Can be achieved via LPAC support and LP vote if existing LPs approve proposal</li><li>▪ <b>GP may help coordinate one-off LP interest secondaries for LPs rejecting the proposal to garner required support</b></li></ul>
<b>MERITS</b>	<ul style="list-style-type: none"><li>▪ Enables LPs with longer hold times to see upside on remaining assets</li><li>▪ GP continues to manage assets and optimize an exit</li><li>▪ Possible reset economics re-incentivize GP</li></ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"><li>▪ Certain LPs may not approve an LPA amendment</li><li>▪ GP may need to retire certain LPs to facilitate LP vote for restructuring</li></ul>

### STRUCTURE



## LP Tender or Co-Sale (Assets Retained)

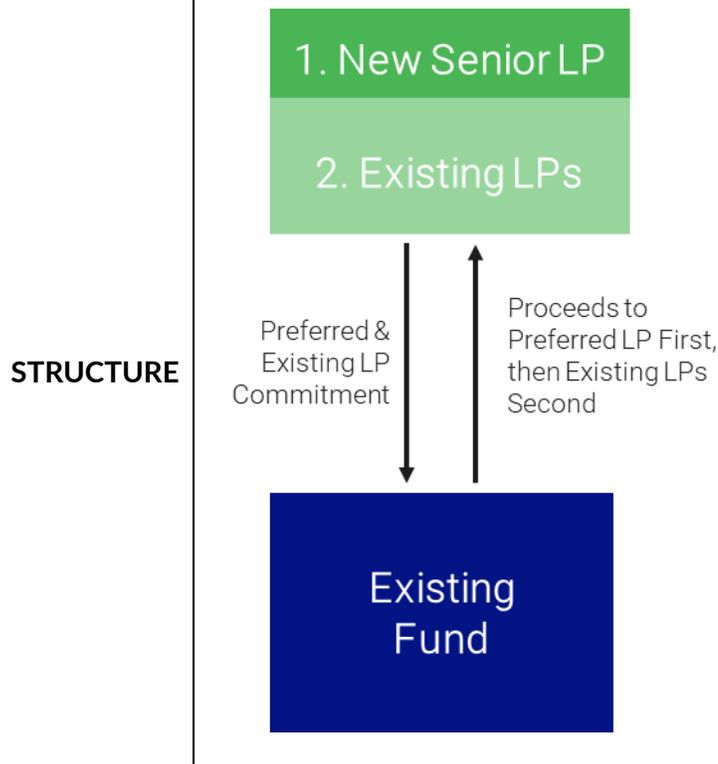
<b>SITUATION</b>	A fund has several LPs who prefer not to wait for the remaining assets to exit
<b>SOLUTION</b>	New LP offers price to purchase existing LP interests at agreed-upon terms, which LPs accept or reject
<b>MERITS</b>	<ul style="list-style-type: none"> <li>▪ LPs who need liquidity can sell their interests and LPs with longer time horizons remain in the fund</li> <li>▪ No new vehicle creation as buyer takes over existing interests in current vehicle</li> </ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"> <li>▪ A full tender process requires a 20-business-day tender period with 10-day extensions for material changes</li> <li>▪ Need experienced counterparty with high certainty of closing</li> </ul>



<b>CO-SALE ALTERNATIVE</b>	<p>Single-selling LP and buyer finalize transfer pricing, which is made available to other interested LPs</p> <ul style="list-style-type: none"> <li>▪ Minimizes GP conflicts (valuation, redemption/exemption)</li> <li>▪ Does not require as lengthy a tender process</li> </ul>
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## Preferred LP Investment (Assets Retained)

<b>SITUATION</b>	A fund is (i) out of capital reserves to (a) protect the portfolio, or (b) take advantage of a unique late-life investment opportunity; or (ii) seeking portfolio liquidity without selling assets
<b>SOLUTION</b>	New LP provides primary capital injection to existing fund in exchange for a senior preferred return
<b>MERITS</b>	<ul style="list-style-type: none"><li>▪ No vehicle creation required as new LP subscribes to existing fund</li><li>▪ New primary commitment can fund follow-on pro-ratas, new investment opportunities, or be distributed to LPs</li><li>▪ Concentrated LP bases can efficiently unlock capital</li></ul>
<b>CONCERNS</b>	<ul style="list-style-type: none"><li>▪ Requires LPAC approval and/or amendment to create separate LP class for preferred commitment</li><li>▪ Opportunity cost must outweigh capital cost of new LP preference</li></ul>



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