

This is a commercial communication from Hogan Lovells. See note below.

ILPA releases considerations for continuation fund transactions

The Institutional Limited Partners Association (ILPA) released [considerations](#) for both limited partners (LPs) and general partners (GPs) in respect of continuation fund transactions, including GP-led secondaries, in May 2023. Continuation funds have become more common in the private equity industry, and ILPA's guidance attempts to establish a shared set of LP and GP expectations for such transactions. The guidance outlines principles on how, when, and to what capacity LPs should be engaged in the process as well as recommendations on disclosures, structure, timing, economics, and other legal considerations.

In general, ILPA recommends two overarching principles: (i) continuation fund transactions should maximize value for existing LPs and (ii) rolling LPs should be no worse off than if a transaction had not occurred.

Among other things, ILPA urges GPs to provide LPs at least 20 business days or 30 calendar days to review the transaction structure, conduct due diligence, and make their election to roll into any continuation fund.

The full 14-page guidance is available [here](#).

Early LPAC (and LP) engagement

The guidance places a fund's limited partner advisory committee (LPAC) at the heart of the process for continuation fund transactions. In addition to any other requirements under the fund's limited partnership agreement (LPA) or other governing documents, ILPA recommends that the LPAC play a central role in reviewing and waiving all conflicts of interest involved in a transaction, including those conflicts that do not technically require LPAC consent under the fund's LPA. ILPA advises that the GP involve the fund LPAC at the earliest opportunity to outline the transaction's objectives, process, and terms, and to provide all of the facts necessary to consider all conflicts of interest between the GP and LPs and as among various groups of new and existing LPs.

Recommended disclosures for transactions

ILPA enumerates in detail a set of disclosures for LPACs and LPs alike designed to allow them to make informed choices about a continuation fund process. For LPACs, detailed disclosure will be crucial in reviewing any conflicts of interests and for determining that the transaction is structured appropriately to ensure a fair price was obtained in relation to conflicts of interest. For LPs, disclosure will be crucial to allowing sufficient time to review the transaction and make an informed investment decision about whether to roll into the continuation fund.

ILPA recommends that GPs should provide the following disclosures about bids and processes to both the LPAC and, eventually, LPs:

- i. Description of the process for soliciting bids from potential acquirers;
- ii. Overview of the bids received (including number of bids and pricing);
- iii. Discounted pricing or more favorable economics for potential acquirers (relative to rolling LPs), including special terms like stapled commitments (*i.e.* where a potential acquirer not only participates in the continuation fund, but also makes a commitment to a new fund sponsored by the same investment manager);
- iv. Any new capital provided by existing LPs;

- v. Any participation by LPAC members as acquirers;
- vi. Any factors that would have excluded certain acquirers;
- vii. Management fee (percentage and dollar amount) and carried interest charged to LPs in the continuation fund;
- viii. Management fee and carried interest charged to LPs allocating primary capital (through a stapled secondary), if any;
- ix. Rationale and amount of any “crystallized” carried interest being rolled into the continuation vehicle; and
- x. Any other meaningful changes in terms versus the original fund (*e.g.* approvals, key persons, or other governance terms).

Moreover, ILPA recommends the following disclosures about selected assets:

- i. GP’s investment memo and returns to date for each selected asset in the continuation fund;
- ii. Asset-specific information required for due diligence related to material risks;
- iii. Detailed information on the basis for the assumed price/multiple for the assets (including details on valuations and any modeling assumptions used);
- iv. The GP’s view on potential returns at exit for each selected asset;
- v. Performance of any continuation fund the GP currently manages or previously managed.

In addition, ILPA urges GPs to disclose any additional conflicts in more complex transactions, such as those involving stapled secondaries. The GP should make itself, as well as the transaction advisor and portfolio company management, available to LPs to address questions about the transaction. The GP should also explain how any transaction could trigger existing key person provisions and detail how the deal team’s time and attention would be split as between the current fund and the continuation fund.

Timing and legal considerations

ILPA recommends that LPs should have at least 30 calendar days or 20 business days to review any transaction proposal, especially in light of institutional requirements or processes that may require several layers of review and decision-making. ILPA also recommends that the GP should convene an LPAC meeting no less than 10 business days before finalizing the terms of the transaction for LP election.

ILPA highlights the importance of complying with the existing fund’s LPA. More recent LPAs may incorporate provisions that anticipate and establish guidelines for liquidity events, while other LPAs will be relatively silent. In both cases, ILPA recommends that the GP should take care to meet existing fund LPA provisions, in particular as to disclosure, conflict approval protocols, voting processes, expense allocations (including broken-deal expenses), and procedures for third-party valuations. That principle also extends to existing side letters, and ILPA recommends that LPs electing to roll into the continuation fund should retain, to the extent practicable, any terms previously negotiated in existing side letters.

In some cases, LPs may simply fail to respond to the election notice; in such case, ILPA recommends that these LPs be treated as liquidating their interests rather than be automatically rolled into the new vehicle.

ILPA-designated stages of continuation fund transactions

Stage 1

GP presents rationale for selling selected assets to a continuation vehicle, first with LPAC and then with all LPs.

Stage 2

GP engages transaction advisor to structure the process, initiate solicitation of bids, and guide the transfer process.

Stage 3

LPAC reviews structure of the process and any related conflicts of interest.

Stage 4

LPAC votes on waiving conflicts associated with waiving the transaction (ILPA recommends **10 business days** to review).

Stage 5

GP solicits bids and formally notifies existing LPs, potential investors conduct due diligence, and GP provides portfolio company disclosures to all existing and potential investors.

Stage 6

GP sends confidential disclosure document to all LPs outlining the final proposed terms, amendments to governing documents and framework for allocating expenses (ILPA recommends existing LPs have at least **30 calendar days** or **20 business days** to review).

Stage 7

LPs elect to (i) roll interests on a *pro rata* basis into the new fund, (ii) sell interests to acquirer on the offered terms, (iii) roll interests into the new fund and purchase more interests, or (iv) some combination thereof.

Economic considerations

The GP should disclose the allocation methodology for transaction fees and expenses as among the acquirer, selling LPs, rolling LPs, and the GP, and ILPA recommends that the GP should bear a portion of the transaction costs if the GP will receive additional fee revenue or stapled commitments. ILPA recommends that the expenses for the formation of the new vehicle be borne by the rolling LPs and the acquirer(s) and that those expenses should be either capped or subject to LPAC monitoring.

ILPA notes that any dilution of existing LPs that arises out of allocation of commitments to new investors should be done on a “fair and reasonable basis.” The dilution can be calculated (i) at the same entry valuation as the original transaction, (ii) at a market value determined by independent advisors at the time the capital goes in, or (iii) mitigated via an alternative instrument that does not dilute the equity interests of the rolling LPs.

ILPA recommends that existing LPs should be provided a “status quo” option that features: (i) no increase in the management fee rate, (ii) no change in the management fee base, (iii) no increase to the carried interest rate, decrease in the preferred return/hurdle rate or other GP-favorable changes to the distributions waterfall, and (iv) no crystallization of carried interest for rolling LPs.

In almost all cases, ILPA urges the GP to roll 100% of the carried interest accrued into the continuation vehicle to ensure an alignment of interests. In those cases where the GP does decide to “crystallize” a portion of the carried interest, ILPA recommends that the GP provide a detailed explanation as to the rationale and the alignment incentives for the new vehicle.

Advisors to the transaction

ILPA advises that the GP should engage an experienced advisor to solicit bids for the assets that will be held by the continuation fund. In particular, ILPA recommends that the LPAC review the GP's selection of the advisor, including the scope of services and details about the fee arrangement, including how the fee is allocated among the GP, existing LPs, and acquiring LPs.

In addition, the LPAC should have the right to avail itself of an independent legal and specialist advisor, if desired, to offer separate counsel on the continuation fund structure, transaction terms, and waiver of conflicts. ILPA recommends that the LPA explicitly allow the LPAC a right to independent counsel and that it should be deemed a fund expense.

Finally, ILPA notes that selling LPs may benefit from an independent assessment of the value of the underlying assets, together with a formal opinion that the cash price offered is financially fair. Notably, among the [wide-ranging private fund reforms](#) proposed in February 2022, the U.S. Securities and Exchange Commission (SEC) would require a fairness opinion and enhanced disclosures for adviser-led secondary transactions. The industry is still awaiting the SEC's final rule, which may vary considerably from the original proposal.

Conclusion

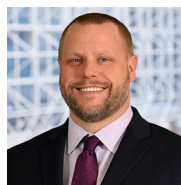
Fund sponsors, especially those considering future liquidity transactions, should familiarize themselves with the new ILPA principles for continuation funds. We continue to monitor ongoing market trends as well as regulatory developments, and we are happy to discuss with clients in greater detail.

** Disclosure: Hogan Lovells has previously represented ILPA.*

Alicante
 Amsterdam
 Baltimore
 Beijing
 Birmingham
 Boston
 Brussels
 Budapest*
 Colorado Springs
 Denver
 Dubai
 Dusseldorf
 Frankfurt
 Hamburg
 Hanoi
 Ho Chi Minh City
 Hong Kong
 Houston
 Jakarta *
 Johannesburg
 London
 Los Angeles
 Louisville
 Luxembourg
 Madrid
 Mexico City
 Miami
 Milan
 Minneapolis
 Monterrey
 Munich
 New York
 Northern Virginia
 Paris
 Philadelphia
 Riyadh*
 Rome
 San Francisco
 São Paulo
 Shanghai
 Shanghai FTZ*
 Silicon Valley
 Singapore
 Sydney
 Tokyo
 Ulaanbaatar*
 Warsaw
 Washington, D.C.

*Our associated offices
 Legal Services Centre: Berlin

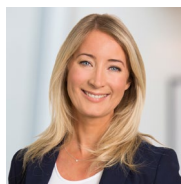
Contributors



Adam M. Brown
 Partner, Northern Virginia
 T +1 703 610 6140
adam.brown@hoganlovells.com



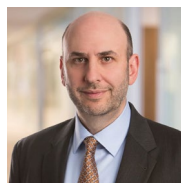
Ed Harris
 Partner, London
 T +44 20 7296 2809
ed.harris@hoganlovells.com



Leanne Moezi
 Partner, London
 T +44 20 7296 5395
leanne.moezi@hoganlovells.com



Parikshit (Parik) Dasgupta
 Partner, New York
 T +1 212 918 3831
parikshit.dasgupta@hoganlovells.com



David A. Winter
 Partner, Washington, D.C.
 T +1 202 637 6511
david.winter@hoganlovells.com



Madelyn Healy Joseph
 Counsel, Washington, D.C.
 T +1 202 637 3667
madelyn.healy@hoganlovells.com



Bryan R. Ricapito
 Partner, Washington, D.C.
 T +1 202 637 5481
bryan.ricapito@hoganlovells.com



Kevin Lees
 Corporate Funds Area Operations Manager,
 Washington, D.C.
 T +1 202 637 5432
kevin.lees@hoganlovells.com

www.hoganlovells.com

"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.

The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members.

For more information about Hogan Lovells, the partners and their qualifications, see www.hoganlovells.com.

Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney advertising. Images of people may feature current or former lawyers and employees at Hogan Lovells or models not connected with the firm.

© Hogan Lovells 2023. All rights reserved. 06876