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GPs get picky on LP-led secondaries

Approved-buyers lists have emerged as a way for GPs to assert their power in secondaries processes and can even be used for strategic purposes – but may not become commonplace just yet. Denise Ko Genovese reports

Denise Ko Genovese
Associate editor

LP-led deals still make up the lion's share of the secondaries market – to the tune of 61%, according to Campbell Lutyens' 2019 survey – compared with the burgeoning world of GP-instigated sales. But GPs are not idly sitting by and have begun to realise their own power in these transactions, most notably in exercising approval rights on sales.

Approved-buyers lists are becoming more common, and terms of LPAs generally dictate that LPs must seek the GP's approval ahead of every transfer. When an LP instigates a sale, a broker is typically charged with getting in touch with the GPs whose funds are on the list. After being informed, a number of the houses may issue a list of varying length with "approved" buyers.

"We have seen numerous GPs become increasingly active in managing their LP base, ensuring that any replacement LPs have the capacity to be with them long term," says Matt Jones, partner and co-head of Pantheon's global secondaries team.

"Secondary deals can be a significant amount of work for GPs, fielding diligence calls and agreeing transfer documentation. It is easy to see why they would prefer to do this work if the replacement LP could bring value to their business in the future," says Jones.

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GPs have a keen interest in making sure they have a roster of LPs that at least have the capacity to back them in future fundraises. This can translate into a preference to work with secondary buyers that have primary platforms.

"When accepting a substitute LP that has no capacity to back you in the long run, that commitment effectively becomes a dead-end for the GP," says Jones.

Daniel Flaig, CEO of Swiss private equity house Capvis, says the firm does not have an approved list for secondary transactions, but is considering it: "In general, it is in the interest of the GP to control its investor base. Existing LPs are also interested in a high-quality investor base with a long-term view, so I see no conflict of interest. The list should not be absolute or closed and allow for new investors over time," says Flaig.

Exaggeration for effect?

It has to be noted that approved lists are still predominantly a mid-market phenomenon; large-cap funds' hefty volume of commitments and wide pool of LPs generally make it unrealistic to exclude potential buyers.

And while most concur that there has been an increase in approved lists over the past few years, some say the uptick is modest and the impact often exaggerated. According to David

Markson, Triago's head of secondaries in the Americas, fewer than one out of 10 GPs are issuing lists that restrict buyers. Kevin Revolte of French asset manager Flexstone concurs, saying that no more than 50% of GPs are restrictive in his experience. The degree of restriction can also vary wildly, from a limited number of buyers in some cases to a long list of approved LPs. In other cases, GPs just want to have a say.

All inclusive

More noteworthy than the increase is the fact that as the number of lists has grown, they are longer and more inclusive, says Triago's Markson: "When GPs issue lists of approved buyers, their motivation is rarely a desire to restrict trade in their funds. Because deals get shopped around and shown to a much wider pool of entities than can possibly buy in a competitive process, a typical motivation is to limit the flow of confidential information regarding strategy, tactics and portfolio companies to a trusted circle."

Indeed, existing LPs usually make up the core, and sometimes the entirety, of these lists. "Almost 80% of our [secondary] transactions are with GPs we are invested with on a primary basis. Often there are restricted processes, since GPs prefer working with buyers whom they know and have a long-standing relationship with," says Pinal Nicum from Adam Street Partners.

Making a fundraising tool out of access to potential secondaries works well as long as fund

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performance is good. When performance falls short, transfer restrictions create restive or even angry LP bases, says Triago's Markson. This helps explain why the overwhelming majority of GPs do not impose restrictive buyer lists on secondary market transactions.

That said, and despite the fact that a minority of GPs use them, the lists have had an impact on the tactics used by active secondary buyers. Unlike 10 years ago, the vast majority of secondary market specialists now have pockets of capital earmarked specifically for primary fundraisings to help them get on approved lists.

"It is obviously not a nice feeling to be excluded, as the behaviour does create barriers to entry, making it difficult to access some funds through the secondary market," says Flexstone's Revolte. "However, if you are not a primary institution, it does create an edge for those who are already in. It is a race for size in this industry, which is facing pressure to get bigger and bigger, so synergies help." Having primary, secondary and co-invest capabilities is a surefire way to curry favour with those few GPs getting increasingly picky come secondaries time. ■