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The Evolution of Private Market Secondaries

Differentiating between LP-led and GP-led secondaries

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- Venture capital and private equity exit activity underwent dramatic declines in 2022: US VC exit value saw a YoY decline of 90.5% while VC exit values in Europe decreased 72.2% over the same period. US and European PE exit values saw YoY declines of 66.3% and 45.1%, respectively. Due to the lack of available exit avenues, allocators have increasingly turned to secondaries as a potential route for liquidity.

- Global annual secondaries transaction volume jumped from $60 billion in 2020 to a peak of $134 billion in 2021. While the volume decreased to $111 billion in 2022,[1] the rapid growth of the secondaries market highlights the ongoing need for liquidity among allocators.

- Historically, the term "secondaries" referred to LP-led secondaries in which an LP with private fund interests would sell its stakes to another LP or a secondaries firm. However, as the secondaries market has evolved, GP-led secondaries have emerged as a significant portion of the market: In 2022, GP-led secondaries accounted for 48% of global secondaries volume.[2]

- There are a number of key differences between LP-led and GP-led secondaries, such as levels of diversification, return expectations, and the speed of distributions.

1: Greenhill Global Secondary Market Review, Greenhill, February 2023.
2: "Global Secondary Market Review," Jefferies, January 2023.

Introduction

One of the first things people learn about the private markets is that they are illiquid. Unlike stocks or mutual funds, if you want to get your capital out of private funds, it may take a while, the pricing mechanism is opaque, finding and working with an intermediary can be difficult to navigate, and the seller is typically at an information disadvantage and so will be fearful of getting an unfavorable price.

Hopefully, most private market investors understand the liquidity profile going in, but external forces can make these holdings problematic from time to time. Sometimes the sudden need for liquidity is investor-specific, but recently, macroeconomic and market influences have led to liquidity concerns among GPs and LPs alike. Though public indexes rebounded slightly in Q1 2023, easing some of the pressure caused by the denominator effect on LP private market portfolios in 2022,[3] exit activity has remained slow. In the US, venture capital exit value fell from $753.2 billion in 2021 to just $71.4 billion in 2022, reflecting a 90.5% decline; similarly, European VC exit value decreased 72.2% from €137.7 billion to €38.3 billion. Private equity exit values did not fare much better: The US saw a 66.3% decline between the $876.7 billion generated in 2021 and $295.8 billion generated in 2022, while Europe experienced a 45.1% decline to €213.1 billion in 2022 compared with the €387.9 billion high in 2021.

Because exits are the main source of liquidity for private market investors, the depressed exit environment has led some allocators to turn to secondaries to free up capital for future or existing capital calls.

Because exits are the main source of liquidity for private market investors, the depressed exit environment has led some allocators to turn to secondaries to free up capital for future or existing capital calls. The global annual secondaries transaction volume jumped from $60 billion in 2020 to an eye-popping $134 billion in 2021.[4] While the 2022 volume came in slightly lower at $111 billion,[5] such tremendous growth within the past few years demonstrates significant demand for liquidity options.

The first part of this note will introduce the players in the secondaries space, the development of the secondaries market, and the players' motivations for engaging in the sale and purchase of fund interests. The second part will dive deeper into the structural differences between LP-led secondaries and GP-led secondaries.

The nature of private market investing

In the usual course of events, an allocator—think a pension fund, a sovereign wealth fund, an endowment, or a wealthy individual or family—will make a commitment to a private market fund, by which we mean a private equity, venture capital, or some other closed-end strategy where a commitment is made but the capital does not change hands until investment opportunities have been identified by the fund manager. This action of committing capital turns the allocator into an LP, as it has signed a limited partnership agreement (LPA), while the asset manager assumes the role of GP for the fund.

3: For more on the denominator effect, see our analyst note Insights Into LPs' Approach to 2022's Market Challenges.
4: Greenhill Global Secondary Market Review, Greenhill, February 2023.
5: Ibid.

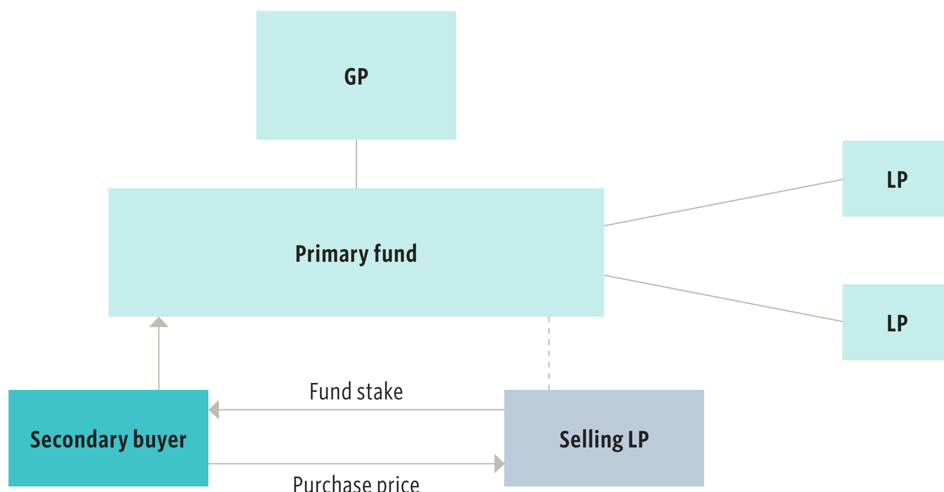
Unlike with a mutual fund, the capital in a private investment fund is drawn down over time, when the asset manager decides to sell a fund investment, and the asset manager will generally distribute the proceeds back to the LPs rather than recycling the proceeds into new investments. Another difference is the timeline. The LPA will have clauses specifying how much time the GP has to invest, manage, and liquidate the fund—typically 10 years, with an option to add two one-year extensions in case the GP determines that the end date is a poor time to sell. The LPs get their money back only when the investments are exited—so it is up to the GP, not the LPs, when the LPs receive their capital and profits.

It is generally not recommended that an allocator become an LP unless its investment time horizon can withstand the uncertainty of this liquidity profile. If the allocator needs its capital to be available at a moment's notice or at a specific point prior to the 10-year end date, it may be unwise to commit to such a long-term fund structure. This is why some of the earliest institutional adopters of private equity were pension funds: They are able to fairly precisely determine when they will need to pay benefits to retirees. Because this time is often very far in the future, tying up some portion of their capital into long-term, illiquid fund investments is generally seen as an acceptable risk to take. For similar liability-matching reasons, insurance companies tend to hold a smaller proportion of assets in private equity, as they may need to be able to access their investment pool at a moment's notice in the event of a catastrophe.

The development of the secondaries market

For some LPs, things do not always play out according to plan, and there are occasions when LPs find themselves needing or wanting to liquidate their illiquid assets. If we think of the original commitment of an LP to a fund as a primary investment, then the LP's trading of that fund is known as a secondary transaction. Historically, the term "secondaries" specifically referred to LP-led secondaries, or transactions in which an LP with private fund interests would sell one or more fund stakes to another LP or secondaries fund, which, with the consent of the GP of the fund being traded, would take over the original LP's interests and capital call obligations.

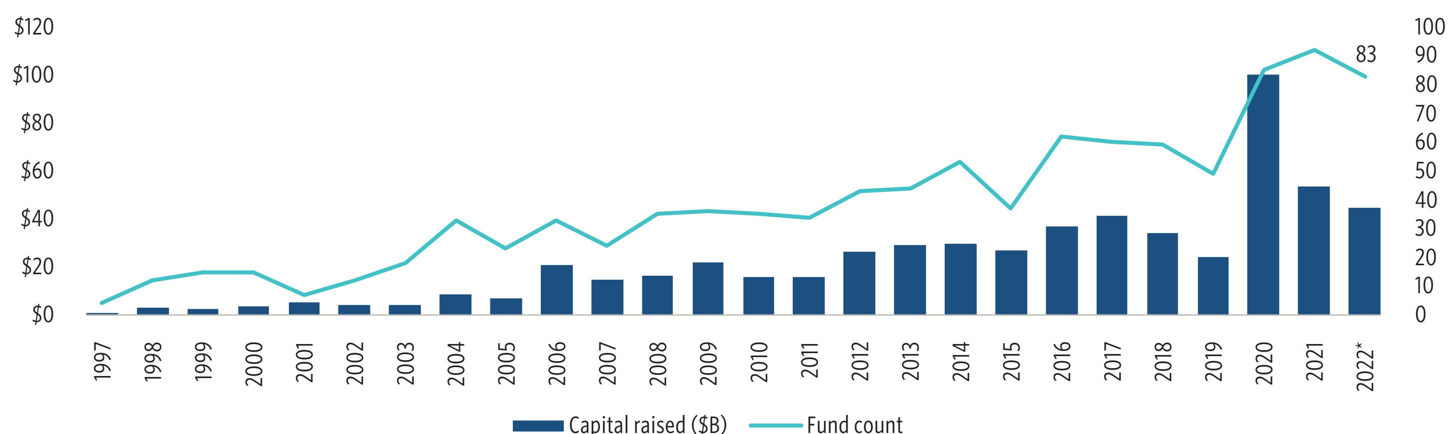
LP secondaries flowchart



Source: PitchBook

The secondaries market began to form in the early 1980s to provide the liquidity that some LPs were seeking. The asset manager Venture Capital Fund of America (VCFA) began to make secondaries investments as early as 1982.[6] According to Coller Capital, VCFA raised the first dedicated secondaries fund in 1984 with $6 million in investor commitments.[7] By 2006, secondaries fundraising had crossed the $20 billion threshold with 33 funds. Annual totals stayed around this level until 2016, when there was a spike to $37.0 billion across 62 funds. In 2020, fundraising numbers hit the stratosphere, generating $100.0 billion for 85 vehicles, six of which were $5 billion or larger. This dramatic total was followed by $53.9 billion raised in 2021, still the second-highest annual fundraising total for secondaries and the most funds closed at 92.

Secondaries fundraising activity



Source: PitchBook • Geography: Global
*As of December 31, 2022

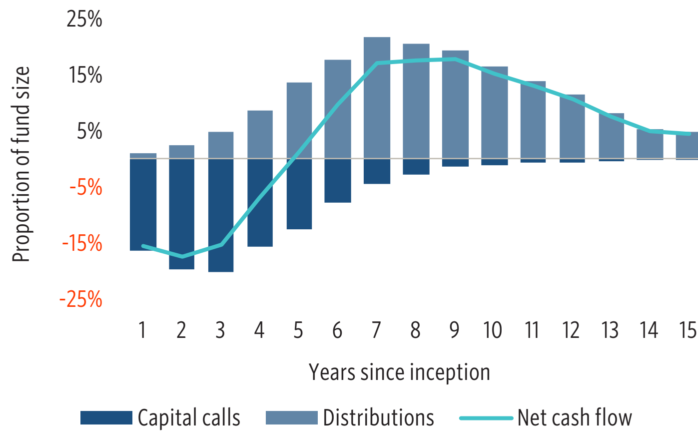
In the early days, it was often assumed that LPs offering up stakes for sale had found themselves in a bind and were highly motivated to sell, allowing secondaries buyers to purchase assets at a significant discount. This resulted in highly attractive returns when the funds exited under a shorter time horizon than primary fund investments. This assumption of LP distress has waned over time, as more LPs have become comfortable with using the secondaries market for a wide variety of reasons. Such reasons might include cleaning out legacy positions when a new chief investment officer is hired, freeing up capital from funds near the end of their lives with little expected remaining upside, and rebalancing from or within the private markets portfolio.

The LPs of secondaries funds commit to these vehicles not only for the returns but also because they love the J-curve mitigation. With a primary fund commitment, an LP will experience negative returns in the first few years as the GP calls capital and fees and acquires portfolio companies that have not recognized any returns. Investors in secondaries funds, on the other hand, have the opportunity to invest in funds that have already completed investments, leading to shorter holding times and earlier distributions. Not only does cash come back more quickly because the

6: "VCFA Group," VCFA Group, n.d., accessed April 11, 2023.
7: "History of Secondaries," Coller Capital, n.d., accessed April 12, 2023.

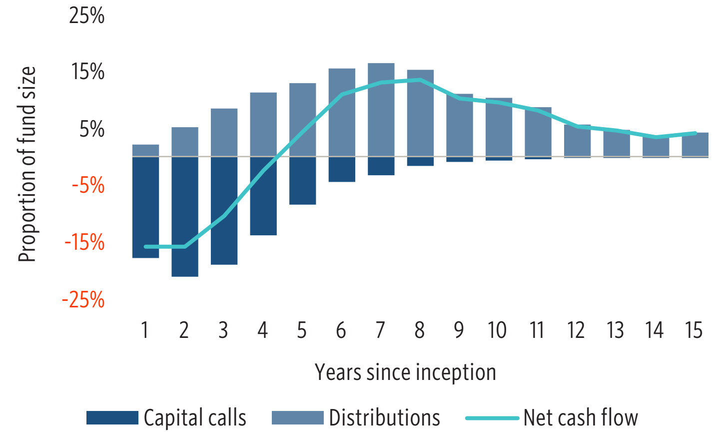
funds are more seasoned at the time of entry than a primary commitment, but if fund interests are purchased at a discount, the investment also gets marked up immediately to the net asset value (NAV) at the next valuation date, so LPs can show their investment committees an immediate return on investment.

Average PE fund cash flow profile*



Source: PitchBook • Geography: Global
*As of June 30, 2022

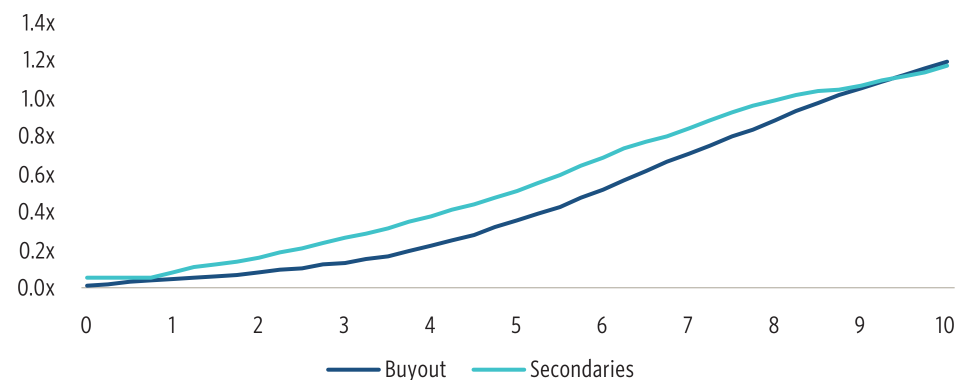
Average secondaries fund cash flow profile*



Source: PitchBook • Geography: Global
*As of June 30, 2022

On average, secondaries funds reach net positive cash flows—where distributions outpace contributions—by the end of year four, while private equity funds do so sometime in year five. Additionally, in the first few years of their lives, secondaries funds return more capital than private equity funds. In year one, the proportion of distributions to fund size for private equity funds comes in at 1.0% versus 2.0% for secondaries funds. By year three, this difference increases to 4.8% for private equity funds and 8.4% for secondaries funds. It is not until year five that private equity returns surpass secondaries distributions at 13.6% and 13.0%, respectively.

Average DPI by strategy and years since inception*



Source: PitchBook • Geography: Global
*As of June 30, 2022

The first evolution of secondaries: Structured solutions

Prior to 2015, most secondaries transactions were "LP-led secondaries": At the instigation of the LP, a secondaries fund or another LP purchased the interest outright. But some LPs had more complicated needs. Perhaps they needed to free up some capital but did not want to crystallize a loss by selling their portfolio at a discount when the markets were also under some stress. Or perhaps they wanted to maintain a relationship with a GP in order to be allowed into a successor fund.

Structured solutions emerged as a method for LPs to achieve partial liquidity while also maintaining some portion of their interest in a fund. Structured solutions encompass a variety of bespoke credit, equity, and hybrid arrangements, as LP needs will be highly specific. In its simplest form, a fund manager using this approach will help LPs move some or all of their private market portfolio into a new vehicle. The LP retains ownership in the eyes of the GP, but the solution provider pays the LP a portion of the assets' NAV, assumes the administration and capital calls of the funds going forward, and then retains the distributions from the underlying portfolio until it receives a minimum return. Once the solution provider receives the minimum return, the LP will participate in the remaining upside of these assets, with a small equity share of the special vehicle providing some limited upside to the solution provider as well.

An asset manager providing these solutions will invest from a fund that is pitched to its own LP investors as an opportunistic fixed-income product with some potential for upside. As an example, in 2021, the Maryland State Retirement and Pension System committed to a structured solutions fund from Whitehorse Liquidity Partners out of their credit allocation.[8] Because of what they are planning to provide to their investors, these funds typically prefer larger, more predictable buyout positions with less chance of extreme return profiles, so if an LP has a portfolio with a mix of fund types, the structured solution may not be based on the entire portfolio but only a subset of the portfolio the fund manager deems appropriate to its strategy.

The second evolution of secondaries: GP-led secondaries

Around the time of the global financial crisis (GFC), GPs with funds nearing the end of their natural lives were in a bind. They did not want to be forced to sell when markets were floundering, but their LPAs stipulated that they had to wind down the funds. In addition to the problem of selling in a distressed market, the underlying companies may have been damaged during the GFC, so GPs wanted time to shore these up—or complete some competition-eliminating acquisitions—before bringing them to market for sale.

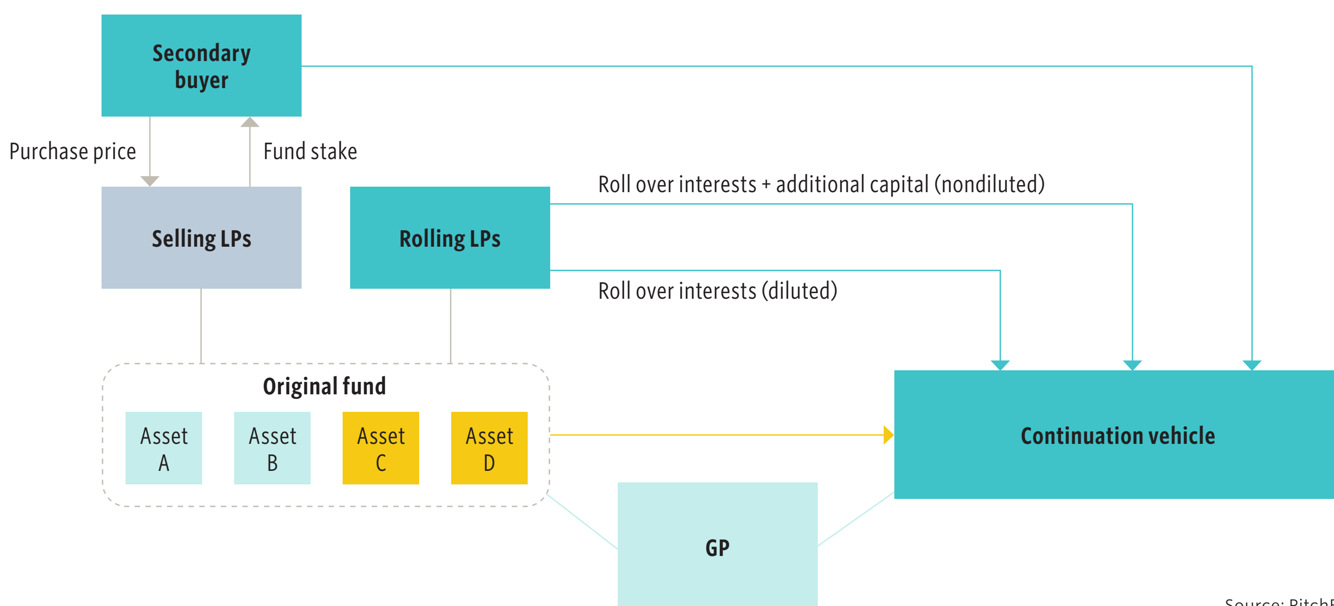
LPs were also facing uncertainty in these times. Were they ever going to get their money back? Could the GPs really execute on their hopes for these long-dated assets? Would distributions dry up so much that it would be difficult to meet obligations? Some LPs wanted to get whatever they could and move on. One of the traditional solutions had been for a GP to buy an asset from a previous fund with its current fund, but that was fraught with conflicts—would the GP advantage the

8: "Maryland State Retirement Discloses $475 Million in Commitments, Investments," Pensions & Investments, Brian Croce, February 18, 2021.

new fund over the old fund in valuing the trade? For those LPs in one fund and not the other, there could easily be a perception that the GP was rescuing one fund with another or that one fund was getting the better deal. In addition, given that the GP was the one making the trade, it was potentially structuring the deal to maximize its own carried interest, another conflict that gave LPs pause in approving these deals. There was also the perception that funds near the end of their contractual lives with a few assets left, sometimes called tail-end or zombie funds, might have assets with limited remaining potential that are not worth holding. GPs are highly motivated to ensure that their prior funds look particularly attractive when they are trying to raise a successor fund, so it is natural for LPs to question the rationale for any change to the original plan of an LPA.

Coming out of the GFC, the need for a third-party solution that allowed for an arm's length transaction gave rise to what is now called the GP-led secondary. In a later section, we will go into detail about how this differs from an LP-led secondary from a variety of perspectives, but in essence, the most common of the GP-led secondaries is a solution whereby the GP works with a secondaries buyer to offer the GP's original LPs an opportunity to exit the fund at a price negotiated by the GP.[9] At the time of the transaction, some or all of the remaining assets in the fund under contemplation are then rolled into a continuation vehicle (CV) that the GP continues to manage. The offer usually allows LPs the choice to 1) accept the offer and make a clean exit, 2) roll their existing stake into the new fund, or 3) roll their stake and agree to commit another sum to support the assets remaining from the original fund, thus avoiding dilution of their stake in what they have been told are prize assets. In the new fund, which will have its own LPA with new financial terms and timeline, some old and some new LPs will continue to participate in the fortunes of these assets.

Continuation vehicle flowchart

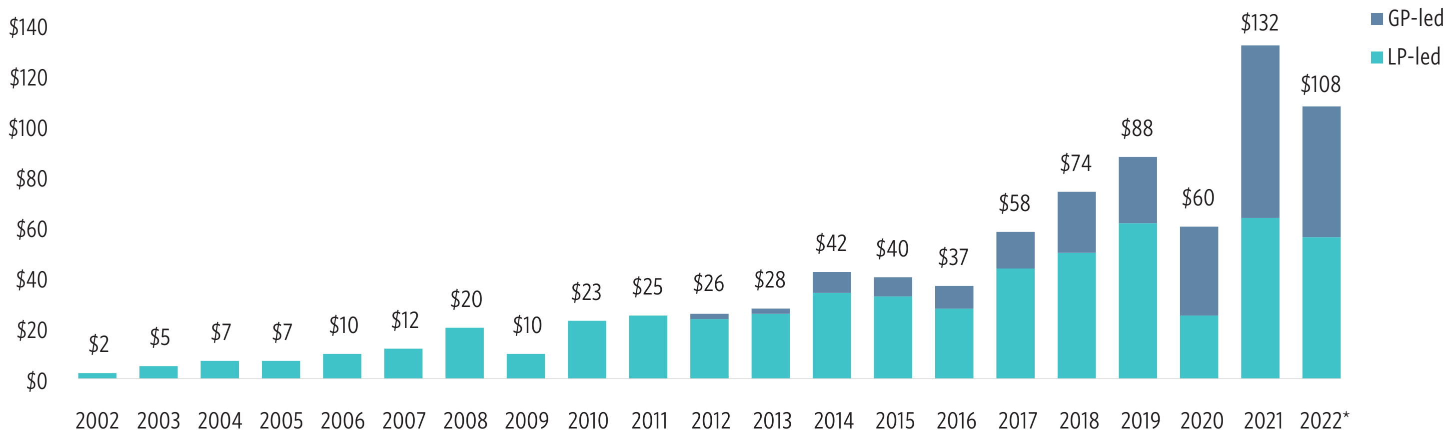


Source: PitchBook

9: According to Lazard's 2022 Secondary Market Report, while continuation vehicles made up 74% of transactions, there are a handful of other GP-led secondaries transaction types, including tender offers, strip sales, and preferred equity. "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.

GP-led transactions made their first appearance in 2012 as a small fraction of the overall secondaries market, accounting for just 7.1% of secondary transactions.[10] However, by 2020—triggered by the difficult exit conditions during the COVID-19 pandemic and inspired by a handful of well-respected managers launching CVs in prior years[11]—GP-led transactions represented 58% of secondary transactions, overtaking LP secondaries volume for the first time.[12]

Secondaries market transaction volume ($B)



Source: Jefferies estimates • Geography: Global
*As of December 31, 2022

The reasons GPs offer this solution can vary. In some cases, the GP has heard from weary LPs that believe they have waited long enough for distributions, but the GP does not feel that it is the right time to sell. The GP may believe that it has one or more trophy assets, but it has run through the original fund's capital commitments and needs more capital to support these names. Sometimes the market happens to be in distress when the GP expected to sell the fund's assets, and the GP wants to hold on for a recovery.

No matter the reason, these GP-led secondaries have become extremely popular as both LPs and GPs get comfortable with the structure. Some LPs had resisted such transactions at first, suspicious of the reasons the GP wanted to change the terms of the original agreement. Additionally, there had been the perception that the assets left in a fund at the end of the originally contemplated investment period were poor-quality assets unable to be sold for significant gain. Either this was not true or a rebranding has occurred, but the pitch now seems to be that these are marquee assets that the GP believes still have significant upside.

Perspectives on GP-led secondaries

Why do LPs sell when presented with a GP-led secondary offer? They may be counting on this fund to wind down in the allotted time and provide distributions to fund further commitments to new funds—with this manager or another. They may believe that locking in the current price offered is better than hoping that the GP is

10: Calculated using data from PitchBook and Jefferies. "Global Secondary Market Review," Jefferies, January 2023.
11: Notable examples include Nordic Capital, which moved nine assets from its 2008 vintage Nordic Capital Fund VII into a CV in 2018, and Accel-KKR, which moved four assets from its 2008 vintage Accel-KKR III fund into a CV in 2019.
12: "Global Secondary Market Review," Jefferies, January 2023.

right about the potential upside—the "bird in the hand" theory. On the flipside, some LPs may stay in—and offer to fund further capital requirements—because they agree with the GP that the asset or assets moved to the continuation vehicle are worth their continued support.

One of the snags in this process for LPs is that many have procedures they must follow in order to get a new fund approved by their investment committee; many of these committees saw continuation vehicles as a new fund despite the vehicles housing assets in which they already had a stake. If the decision time did not allow for a quorum vote by the LP's governing body, the LP would be forced to take the sale option, regardless of how it felt about the proposal.

For GPs, these GP-led transactions can solve a few problems. They may be able to crystallize some carried interest on this "sale" to another fund—though for alignment reasons, more and more secondaries buyers are insisting that GPs roll any carried interest from the former fund into the new vehicle to re-invest into the transferred assets. Second, they can appease LPs that are getting frustrated with funds dragging on longer than originally intended. Third, they can hold on to assets they know intimately from several years of ownership and arrange for additional capital to support these assets into their next phase of development. Prior to the GP-led secondary surge, GPs would often say that because their most common exits were to other sponsors, the original GP had to leave some upside on the table to entice another PE buyer. With GP-led secondaries, the GP does not have to give this away. Fourth, by providing liquidity to existing LPs, those same LPs may be more inclined to commit to successor funds from that GP, lessening the GP's future fundraising burden.

Why do secondaries fund managers like these transactions? If they can truly identify excellent assets, they can assemble a fairly concentrated portfolio similar to a direct PE fund, but without the blind pool risk. The assets are more seasoned, and fund managers are able to get added comfort from the fact that the GPs already know these assets very well. The continuation vehicles are typically set up to run for five years with perhaps one or two one-year extensions. Secondary funds that focus on acquiring stakes in GP-led vehicles are thus a very different animal to the standard secondary fund—instead of potentially more than a thousand portfolio company holdings, there could be a couple dozen. Because of this, cash flows may be lumpier, as distributions are dependent upon fewer holdings and much bigger positions in each holding. Distributions will likely come later on average than they would for an LP-led secondary, as a continuation vehicle would be unlikely to be set up if an exit was imminent, but the holding period should be limited to about five years.

Differentiating between LP-led and GP-led secondaries as an investment opportunity

LPs seeking to make commitments to a secondaries fund have choices to make. While most general secondaries funds will have some mix of LP- and GP-led secondaries, there are now vehicles that focus entirely on GP-led secondaries. According to a survey conducted by Evercore Private Capital Advisory, going into 2023, 29% of secondaries fund buyers expected to pursue LP-led deals, while 22%

The concentration of continuation vehicles can prove problematic if there are rules in the LPA around concentration; limits could easily be exceeded if a fund were to focus mainly or exclusively on GP-led secondaries.

preferred GP-led deals; 49% had no preference.[13] In this section, we will go into what differentiates these strategies from a risk and return perspective, allowing allocators to gain a better understanding of how these funds might fit into their own portfolio framework.

Diversification

GP-led secondaries transactions involve very few underlying portfolio companies. Many continuation vehicles are set up with either one company, known as single-asset transactions, or a handful of companies, known as multi-asset vehicles. For a secondaries fund, this can prove problematic if there are rules in the LPA around concentration, such as that no one asset may be a certain percentage of the overall fund; this limit could easily be exceeded if a fund were to focus mainly or exclusively on GP-led secondaries. For that reason, dedicated GP-led secondaries funds were created with the expectation that these funds would look quite a bit like a primary fund with a limited number of portfolio companies and the fate of the fund resting on the performance of these few names.

Compared with a primary fund, however, GP-led secondaries funds are buying seasoned assets alongside GPs that have often rolled a significant portion of their carried interest from the fund from which the continuation vehicle spun out. This alignment can lessen the perceived risk of the fund compared with a primary fund, though the potential outcomes of one of these funds may be less predictable than those of a typical secondaries fund that houses LP-led secondaries representing hundreds or thousands of underlying portfolio companies across various vintages.

Return expectations

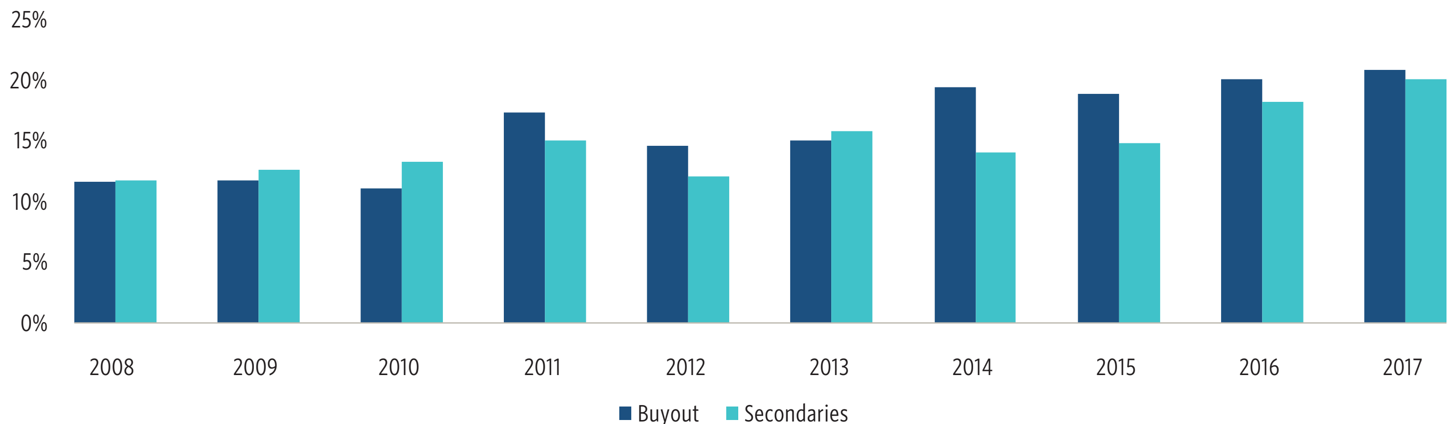
From the perspective of the fund manager pricing secondaries purchases, asset concentration can influence the returns they underwrite. The single-asset transaction carries the highest level of risk; as such, investors that participated in deals of this type in 2022 often targeted at least a 2.1x net return on an unleveraged basis.[14, 15] Transactions with multiple assets offer more diversification, helping mitigate concentration risk. As a result, most GPs investing in multi-asset CVs in 2022 targeted a slightly lower multiple of 2.0x without leverage.[16]

Compared with GP-led transactions, LP portfolio stakes have many more underlying assets from different funds and vintages, supplying a much higher level of diversification. This leads to a more predictable return profile, leading purchasers of LP portfolio stakes to generally target lower return multiples. In 2022, LP-led deals with vintages between 2012 and 2016 targeted net multiples of 1.6x, while 2017 and newer vintages, with less mature portfolios and thus more uncertainty in the eventual outcome, targeted net multiples of 1.7x.[17] It is important to distinguish the risk/return profiles of tail-end LP secondaries versus newer-vintage LP secondaries.

13: "2022 Secondary Market Survey Results," Evercore Private Capital Advisory, February 2023.
14: "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.
15: The use of leverage is more common in LP-led deals than in GP-led deals, as banks prefer to lend to vehicles with significant diversification.
16: "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.
17: Ibid.

Tail-end vintages are those that are more than 10 years old and are priced at steeper discounts than newer-vintage LP secondaries because of the limited upside that tail-end portfolios are expected to provide. As such, according to respondents in a survey conducted by Lazard, 52% of investors in tail-end LP secondaries are targeting net multiples of less than 1.5x but higher IRRs, as they expect distributions to come more quickly. Conversely, 87% of those investing in newer-vintage LP secondaries are targeting multiples greater than 1.5x but have lower IRR expectations.[18]

Median IRR by fund type and vintage year*



Source: PitchBook • Geography: Global
*As of September 30, 2022

The chart above shows the median IRR achieved by secondaries funds against those achieved by buyout funds. It is important to note that because continuation vehicles are such a new phenomenon, the data reflects the IRR of the secondaries universe as a whole, commingling both LP-led and GP-led funds. Secondaries funds raised in times of stress in the financial markets have managed to outperform buyout funds, but in vintages when PE is most in favor, secondaries do tend to lag, as the universe as a whole will include some real assets, venture, and even private debt.

Speed of distributions

Due to the mature nature of traditional secondaries and their J-curve mitigation, it is typical for incoming buyers of these stakes to expect distributions earlier in the life of the fund than they would with a primary fund commitment. While this will still be true for a GP-led secondary deal, the cash flows are likely to be much lumpier. Investors in GP-led deals generally do not expect distributions until after the third year of investment, whereafter they expect a full exit between years three and five. As such, investors that are considering participating in continuation vehicles—either as a new investor or as an existing LP rolling over their interests from the old fund into the CV—must assess whether or not they have ample time to re-invest into a vehicle for another three to five years. In 2022, 78% of LPs opted for liquidity and 22% chose to roll their interests into a CV deal.[19]

18: "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.
19: "2022 Secondary Market Survey Results," Evercore Private Capital Advisory, February 2023.

GP-led continuation vehicles generally charge a 1% management fee, but only on invested capital, so the total fees of a GP-led secondaries fund may be somewhat lower than a more typical secondaries fund.

Fees and hurdles[20]

While management fees on primary fund investments are usually 2% on committed capital during the investment period, secondaries fund fees are commonly between 0.75% and 1.50% on committed capital. Of course, the LP of a secondaries fund will also be paying fees to the underlying fund interests that the secondaries fund has acquired, though these fees will be hidden, rolled into the net return of the secondaries fund. GP-led continuation vehicles generally charge a 1% management fee, but only on invested capital, so the total fees of a GP-led secondaries fund may be somewhat lower than a more typical secondaries fund. In the case of a secondary in which an LP is simply replacing another LP directly, the incoming LP will inherit only the obligation of paying the GP's remaining management fees.

For many primary funds, there is an 8% preferred return; in the most basic sense, this means that the GP provides all sale proceeds to LPs until they have received all of their capital back plus an 8% return before the GP is entitled to take an incentive fee. In contrast, it is common to see GP-led transactions with tiered hurdle structures. For instance, there may be an initial 8% hurdle rate that, once surpassed, will allow the GP to collect a performance fee of 10% with catch-up; then the hurdle rate will be increased to 12%, and once that is reached, the GP will receive a performance fee of 15% with catch-up, and so on. While there is seemingly unlimited variety in the terms of GP-led secondaries deals, one thing we have heard is that GPs are increasingly willing to re-invest a meaningful portion of their original fund's carry proceeds—between 50% to 100%—into CV deals alongside incoming secondaries buyers. Some GPs even invest additional out-of-pocket capital to increase alignment with their investors to sweeten the deal.

Discounts

For a variety of reasons, secondaries pricing is typically quoted in terms of a discount to the GP's most recently stated NAV. On occasion it is a premium, but because buyers want to ensure a positive return on mature assets that may not have a lot of future upside, and buyers will have to assume responsibility for paying fees for the remainder of the fund's life, the pricing is typically some value below NAV.

In 2022, LP-led transactions offered greater discounts than deals conducted on the GP side. Around half of LP-led transactions were priced between 80% and 89% of NAV, while nearly a quarter of transactions were priced at less than 80% of NAV. Only 8% of transactions were priced at or above NAV.[21] The pricing of buyout fund secondaries decreased from 97% of NAV down to 84%; venture capital fund secondaries underwent an 11% decline and ended 2022 with 68% discounts to NAV.[22] While public market valuations dropped significantly, NAVs barely moved, and secondaries buyers were unwilling to bet that the public market declines had not impacted private asset valuations.

20: For more on the fine print of private market fees and terms, we recommend this analyst note from our research library.
21: "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.
22: Greenhill Global Secondary Market Review, Greenhill, February 2023.

On the other hand, the majority of GP-led transactions were priced only slightly below or at NAV: 59% of GP-led transactions were priced between 90% and 99% of NAV, while a further 28% were at NAV or even trading at a premium.[23] However, having spoken with a handful of global secondaries advisory firms in early 2023, we see evidence of increased downward pressure on GP-led transaction pricing as more GPs are entering the market. In addition, secondaries buyers may be tilting back to LP-led secondaries while that pricing remains more heavily discounted. It should be noted that the sticky GP-led discounts might be more of an indication of what deals were accepted rather than what buyers are willing to pay. When we spoke with market participants, some mentioned that there were wide bid-ask spreads, as what buyers were offering was not agreeable to GPs.

Due diligence

With an LP-led purchase, every portfolio company is a very small portion of the overall portfolio, so spending a lot of time on due diligence for a tiny position is unlikely to provide significant risk mitigation. The focus is instead on the quality of the managers controlling the funds. As a result, when assessing an LP portfolio stake of multiple funds, a prospective investor will likely call each of the managers of the underlying funds to walk through the portfolio, exit timing, uplift expectations, and other high-level due diligence considerations.

Because single- or multi-asset vehicles are so concentrated, it is advisable for an incoming investor to perform due diligence on both the fund and each portfolio company.

When making an investment into a GP-led continuation vehicle, on the other hand, the due diligence process is more granular: Because single- or multi-asset vehicles are so concentrated, it is advisable for an incoming investor to perform due diligence on both the fund and each portfolio company. Prospective investors will sometimes turn to third-party advisors to supplement their commercial and financial due diligence efforts with fairness opinions—reports detailing whether or not the pricing offered to prospective investors is justifiable given the underlying assets—to ensure that GPs are fulfilling their fiduciary responsibilities to their investors in offering fair pricing.

23: "Lazard 2022 Secondary Market Report," Lazard, February 14, 2023.

Conclusion

The secondaries market has evolved dramatically since its inception and continues to do so as GPs and LPs alike seek bespoke liquidity solutions in an ever-changing market. Investors that are interested in participating in buying secondaries should consider a variety of factors, including diversification, return expectations, and their immediate liquidity needs, when choosing between traditional secondaries, GP-led secondaries, or a mixed portfolio.

Differences between LP-led and GP-led secondaries

	Diversification	Return expectations	Speed of distributions	Fees	Discounts	Due diligence
LP-led secondaries	More diversified	Tail-end vintages target slightly lower multiples and higher IRRs Newer vintages target slightly higher multiples	Begin early in the fund life but total liquidation time frame likely longer	Total fee burden higher due to primary fund fee structure	The majority of transactions traded at < 90% of NAV	Due diligence primarily at fund level
GP-led secondaries	More concentrated	Single-asset vehicles target higher multiples than multi-asset vehicles to compensate for higher concentration risk	Between years three and five	Total fee burden lower due to CV fee structure	The majority of transactions traded at > 90% of NAV	Granular diligence on each asset and third-party advisor's fairness opinion

Source: PitchBook

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