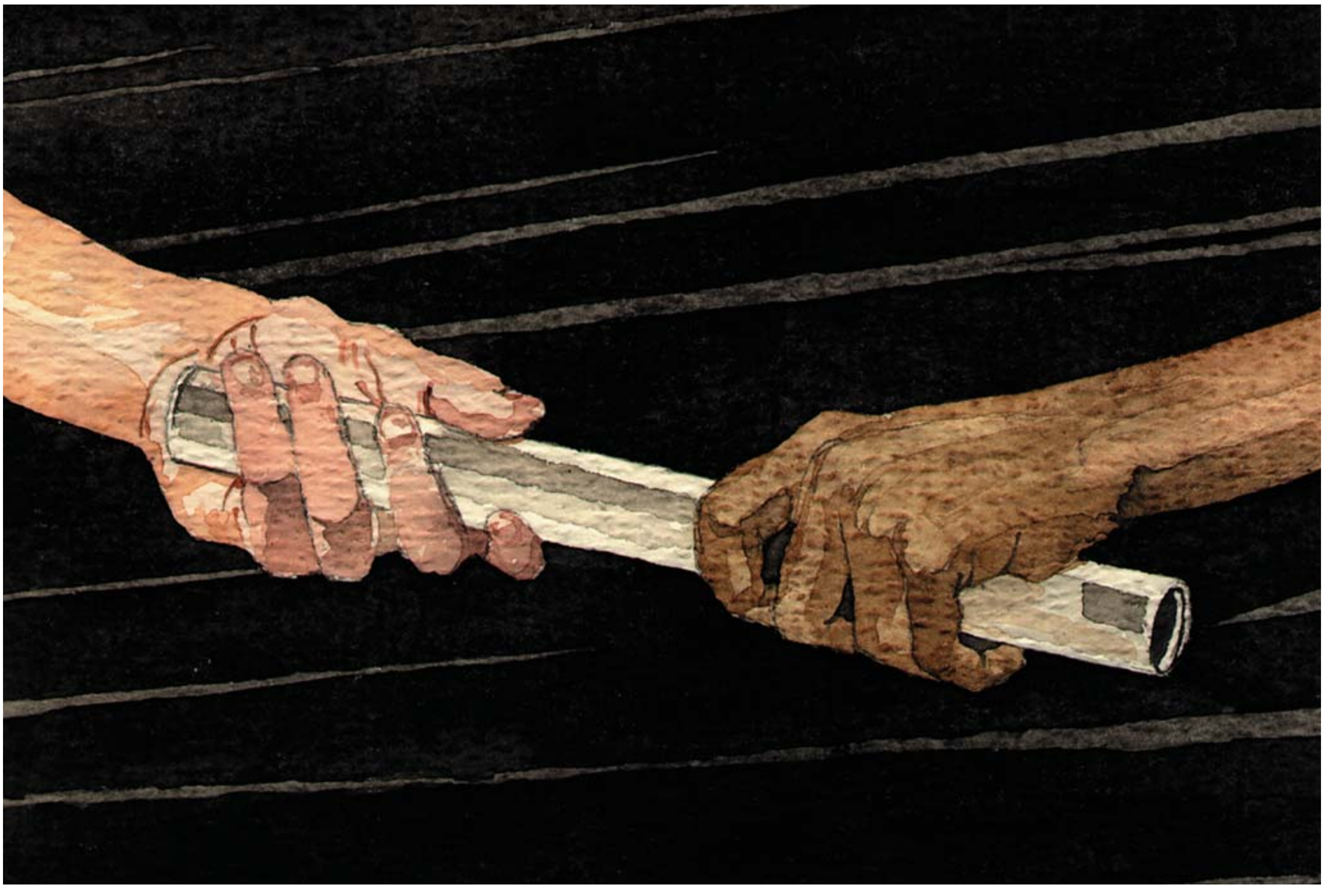
# Secondary sales

## Demystifying a growing trend

**James Burdett** and **Gabriel Boghossian** of **Baker & McKenzie LLP** examine the practical and legal issues surrounding secondary sales of investment fund interests.

Illustration: Getty Images



With transactional deal flow at historic lows, the continued growth in sales of private equity fund interests (so-called secondary sales) has bucked the trend. Parties recently reported to be marketing secondary interests include financial institutions facing liquidity constraints such as Royal Bank of Scotland Group plc and HBOS, as well as several university endowments and other institutional investors. After many years, the private equity secondary sale seems finally to be losing its reputation as a niche asset class for a limited field of specialist funds, and is establishing itself as a recognised investment in its own right.

Record amounts of capital dedicated to secondary fund assets have been raised in recent years, including several multi-billion dollar funds such as Coller International Partners V ($4.8 billion), GS Vintage Fund V ($5.5 billion) and Lexington Capital Partners VI ($3.8 billion). While dollar denominated, the vast majority of these funds have an international remit and many are managed out of the UK. Several funds have also been raised to target real estate fund secondaries. However, while the market is growing rapidly, it is doing so quietly. With few exceptions, secondary transactions happen out of public view and are rarely announced.

A secondary sale, in its simplest form, is the transfer of the interest held by an investor in a private equity fund (or any other ***closed-ended*** (*see box "Key terms"*) investment fund; for example, a real estate fund) before the end of the fund's term. Private equity funds are commonly established as limited partnerships, so the interest being transferred will be an interest in the limited partnership, but the buyer will assume the liabilities attached to that interest, most notably the legal obligation to meet all future ***capital calls***.

## WHY SELL?

Investors' motivations for selling out of their fund positions vary widely, but generally can be divided into three categories:

### Liquidity issues

The closed-ended limited partnership structure of private equity funds means that individual investments are highly illiquid until the fund reaches its term (typically seven to ten years) (*for background, see feature article "Private equity funds: US and UK features", www.practicallaw.com/5-102-3098*).

Currently, a significant number of investors are suffering liquidity problems; they risk being unable to meet future capital calls from the funds in which they are invested, and will likely face draconian penalties for a default under the fund's limited partnership agreement (LPA). In order to meet the demands of their own investors, or to create liquidity (for instance, to satisfy bank covenant tests), some investors are being forced to divest their private equity holdings. Therefore, a secondary sale results in both a reduction in the investor's outstanding commitments and, to the extent that the sale generates cash proceeds, an immediate improvement in its liquidity situation.

### The denominator effect

Institutional investors will usually allocate only a part of their capital (say, 15%) to private equity and alternative investments. Such investors have seen a continued drop in value of listed securities and other investments that can be ***marked to market*** relatively easily, compared with their illiquid private equity investments (these are difficult to value anyway, and are likely to be valued only on a quarterly basis which means that the private equity write-downs also lag several months behind, and most portfolios have yet to be fully written down). As a result, many institutional investors now find that their investment portfolios are over-allocated to private equity. This so-called "denominator effect" is leading to increased secondary sales in an effort to re-balance such investors' portfolios.

### Portfolio management

Secondary sales are increasingly being used as a tool in an "active portfolio management" strategy. Investors rely on secondary sales to crystallise early returns, change investment strategy or to reduce exposure to a particular private equity sub-class such as venture capital, buyout or mezzanine funds. Many investment managers also rely on secondary sales to cull low-performing funds, allowing resources to be deployed to investments with the potential for greater returns.

In addition, secondary sales allow investors to rebalance their portfolios and reduce their exposure to a particular ***vintage year***, as returns historically vary widely from year to year. This ability to actively manage a previously illiquid investment is proving very attractive and allows for a greater degree of flexibility in investment strategy.

Lastly, as the investment holding period is a significant factor in the ***internal rate of return*** (IRR) equation, the exiting investor's IRR resulting from a secondary sale can also be higher than if the investment is held to maturity.

## WHY BUY?

The increased supply of private equity interests for sale has led to a much wider pool of buyers approaching the market, in addition to the existing dedicated secondary market participants. Their interest is in benefiting both from the commercial and strategic advantages that a secondary purchase offers over a primary investment.

### Commercial advantages

Secondary purchases present an opportunity both for high returns and a shorter investment period. Fund interests are generally valued on a quarterly basis (*see "The denominator effect" above*), and the acquisition price is generally based on the most recent quarterly net asset value (NAV) of the fund.

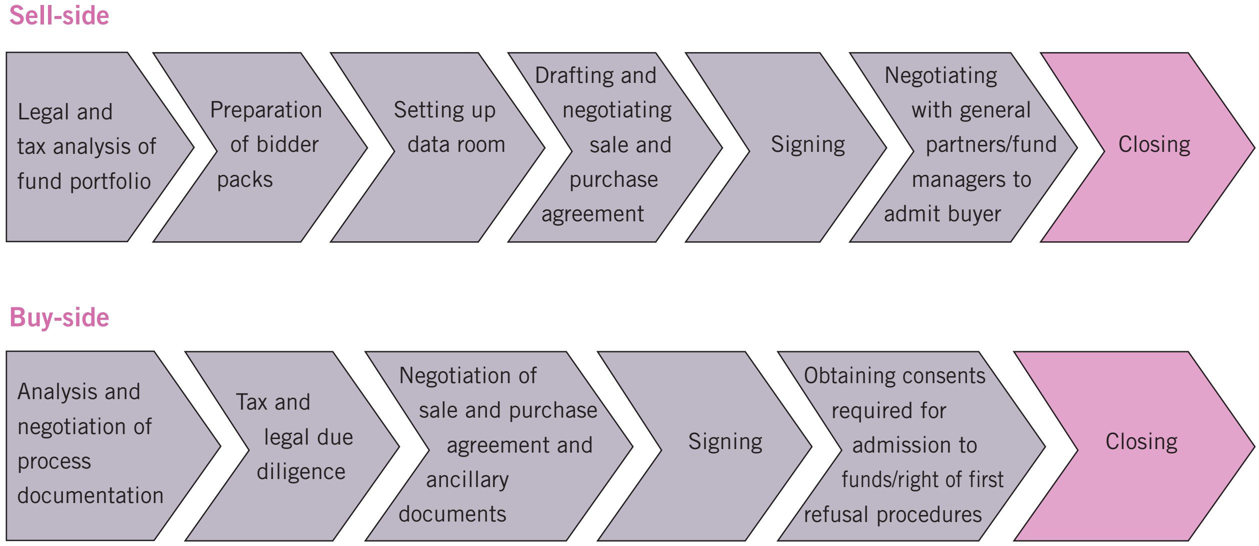
In recent years, secondary interests have even sold at a slight premium (up to 10%) to NAV. However, the financial crisis has forced the hand of a number of investors, and has led to discounts to NAV increasing considerably: in some situations discounts have reached 65% or more of March 2009 NAV. However, such headline discounts may be misleading, as secondary investors are generally pricing in an anticipated fall in the underlying fund's NAV which may only be reflected in the fund's future valuation statements. The fact remains that supply far exceeds demand in today's secondaries market.

Where a limited partnership interest in a recent vintage year is being marketed, frequently with less than 25% of the investor's committed capital drawn down (often referred to as an "early stage secondary"), it is not unheard of for the discount to reach 100% (that is, nil cash consideration). In return, the buyer agrees to assume responsibility for the seller's future unfunded commitments.

In general, buyers are more interested in funds which are fully (or nearly fully) invested. This allows them to value a defined portfolio of companies, rather than investing on the basis of prospective future investments. In fact, where the buyer is a dedicated secondaries fund, this requirement is sometimes enshrined as an investment limitation in the buyer's own LPA.

Investing in mature interests also allows for an acceleration of buyers' cash flows, as the fund will be some way along its investment period and will exit its investments sooner. Higher management fees, expenses and early write-offs are typically features of the early stages of the investment cycle, whereas years four to

## Steps to a secondary sale




ten are typically the realisation period in a fund's life cycle and account for the majority of distributions, and most funds reach cash flow break-even in year six or seven. This makes these older funds more attractive to prospective buyers, as buyers of mature interests are generally able to guarantee themselves a higher IRR than that achieved by original fund investors.

Many investors are now looking at secondary purchases because of the long holding periods which are envisaged for any new investments being made. Investors are unlikely to see returns on primary commitments in the near term, so investments in secondary interests are used to improve cash flow.

### Strategic advantages

As well as allowing the buyer to access an instantly diversified portfolio covering new sectors and better vintage years, secondary purchases also open new relationships with fund managers/general partners (GPs). Top-tier GPs typically have longstanding relationships with their limited partners, and few new investors are added to each successive fund. A secondary purchase opens a relationship with the GP that increases the likelihood of participating in future funds (*see "Stapled transaction" below*). As a result, institutional investors were, in recent years, willing to pay above-market prices for assets managed by top-tier GPs, with the goal of obtaining an allocation in the manager's new and oversubscribed fund.

From a GP's perspective, a secondary purchase also has potential strategic benefits. In addition to adding a new investor to the GP's investor base, the purchase allows the exiting investor to stay on good terms with the GP while enabling the GP to cast adrift an underperforming and illiquid investor. It also allows the GP to source deals with the confidence that drawdown requests will be honoured by its investors.

Secondary purchases can also have a complementary effect in offsetting a negative feature of early primary commitments to private equity funds by skipping the initial drop in value associated with the typical ***J-curve*** performance profile of a private equity fund.

## STRUCTURING A SECONDARY SALE

Although secondary transactions are structured in a variety of ways, not always involving a sale (*see "More complex structures" below*), they generally involve five main stages for sellers:

- Approaching GPs.
- Facilitating buyer due diligence.
- Marketing the fund interests.
- Negotiating the sale and purchase agreement (SPA).
- Transferring interests to the buyer.

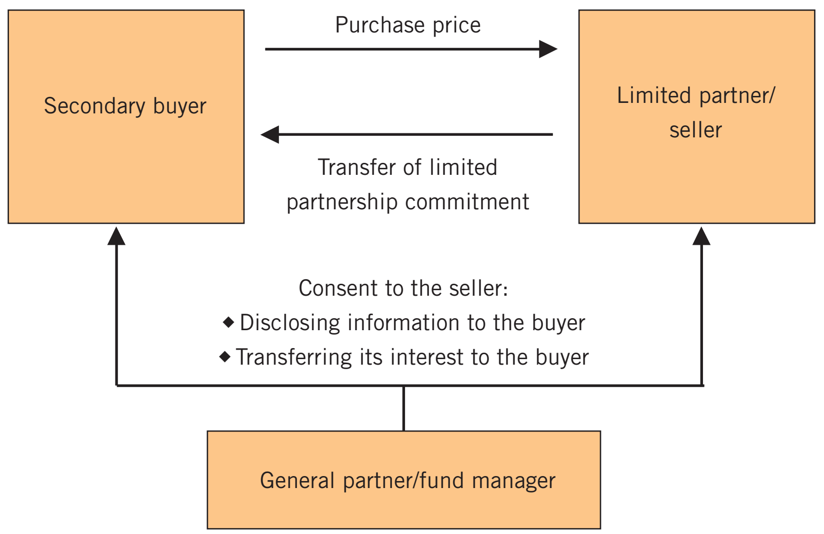
(*See box "Steps to a secondary sale"*.)

### Approaches

Almost without exception, an LPA will require that the GP provide its consent to a transfer, and some LPAs contain an additional requirement for the GP's consent to the specific buyer becoming a substitute limited partner (*see box "The consent structure"*). Although the LPA may provide that such consent will not be unreasonably withheld, the GP can generally make the decision in its sole discretion and is not required to give reasons, nor to provide any information or assist with the transfer process. The GP will want to assess various factors including the creditworthiness of the transferee before giving its consent; GPs typically prefer an institutional purchaser that has the potential to commit to additional funds raised by the GP in the future, rather than a secondaries fund as purchaser.

As such, most successful transactions have sellers working closely with GPs to identify appropriate substitute investors before a sale process begins. Engaging with the GPs at an early stage not only reduces the transfer risk; it also preserves the seller's relationship with the GP and its reputation in the marketplace.

## The consent structure




However, it is not unusual for a seller to want to delay notifying or engaging with the GP until it has reached a binding deal with the buyer, and then present the GP with a fait accomplis. Such a strategy, while understandable, is not without its dangers, and a seller should carefully consider both the confidentiality and transfer provisions in the LPA and the consequences of default under them, before pursuing this route.

**Right of first refusal.** Right of first refusal (ROFR) provisions found in certain fund documents allow the GP and/or the existing investors an opportunity to acquire the selling investor's interest under the terms and conditions offered by the prospective buyer. This may have a depressing effect on the price of the individual interests in question (and may deter bidders from making an offer) and, in any event, will extend the time it takes to transfer the interest. In the case of a portfolio sale, this is sometimes circumvented by allocating an artificially high price on the interests subject to a ROFR and lower prices on other interests.

### Buyer due diligence

Any buyer (including buyers already invested in the same fund) will require a period of legal and financial due diligence. Private equity and other closed-ended investment funds are, by their nature, non-transparent and secretive. As a result, buyers will require access to financial, constitutional and other legal documents relating to the fund and the performance of the manager.

Financial documents will include the quarterly and annual financial reports and valuations provided by the fund manager to its investors, as well as all capital call documents (also known as drawdown notices) and distribution notices. The legal documents will include the original LPA and the private placement memorandum or information memorandum, any side letters negotiated with the seller (and, if available, those with the other investors), legal opinions, and any subsequent amendments to the LPA (*for further information on the documents involved, see feature article "Private equity funds: US and UK features", www.practicallaw.com/5-102-3098*).

Tax due diligence should identify the ownership structure and location of the underlying assets. This will enable the buyer to establish whether any local transfer taxes will be imposed in the jurisdictions in which the underlying assets and any holding companies are established, and, if so, on whom the transfer tax liability falls. Tax due diligence should also establish whether any other taxes would be imposed by the jurisdictions of the holding company or underlying assets on a future disposal of the partnership interest by the buyer.

Typically such information will be presented in a data room, and the responsibility for gathering information and creating a data room generally falls on the seller's legal advisers. Fund documents and financial reports accumulate over the life of each fund, and with some portfolio sales of over 50 fund interests, the sheer volume of documents can prove a challenge to locate and index efficiently. On large portfolio sales, further sub-division between sub-asset classes and geographic areas can be useful.

In an auction sale, the seller will also typically prepare "bidder packs". These include an information memorandum produced by the seller (or an intermediary instructed by the seller). This document provides details of the various fund interests as well as summarising key information on the financial performance of the underlying funds. This will be sent to the prospective bidders along with the process letter which will indicate a deal timeline and rules for the auction process. The process letter typically sets dates for: a binding, written offer; a detailed description of the buyer's funding sources; financing commitment letters; and a marked-up copy of the SPA.

### Marketing the fund interests

Where a portfolio of fund interests is being marketed, a competitive auction can be the best way to control the due diligence process and maximise the price achieved. The seller will want to secure a list of high quality bidders, since many "premium" GPs are selective as to whom they will admit as a substitute investor.

**Purchase option.** Some institutional buyers involved in secondary auctions request that a purchase option be granted to them in the event that they are beaten into second place by a rival bidder. Such an option is designed to give the unsuccessful bidder a "slice" of the deal at the same price and on the same terms as the winning bidder. It can be structured as a conventional transfer of a proportion of the seller's interest in each fund (say, 30%) or can be structured as an indirect transfer whereby the

## Taxation issues

English limited partnerships are, generally, not treated as taxable entities for UK tax purposes: they are treated as fiscally transparent entities. This means that for UK tax purposes, the disposal of an interest in a limited partnership is treated as a disposal by a partner of its fractional share in each of the partnership assets (*section 111, Income and Corporation Taxes Act 1988 (ICTA), replaced from 1 April 2009, with effect for accounting periods ending on or after that date, by section 1258, Corporation Tax Act 2009 and section 848 Income Tax (Trading and Other Income) Act 2005 (ITTOIA)*).

The fractional share of the limited partnership assets which a partner owns is determined by that partner's entitlement to profit. Consequently, the profit entitlement also determines the portion of the gain (or loss) arising from the disposal of the limited partnership asset that a partner is taken to receive, and determines the acquisition cost of the asset that is apportioned to a limited partner (*sections 198 and 853, ITTOIA*).

The limited partner disposing of the interest will only be liable to pay UK tax on any resulting chargeable gain if it is within the scope of UK tax.

**Corporate partners.** It should be noted that special rules apply to limited partnerships that have corporate members (*sections 114 and 115, ICTA, replaced from 1 April 2009, with effect for accounting periods ending on or after that date, by sections 1256-1266, Corporation Tax Act 2009*). A corporate partner will not be assessed to capital gains tax but rather gains arising from the disposal of a partnership asset will be charged to corporation tax. Corporation tax rules also apply in calculating, among other things, capital allowances and losses from other accounting periods.

A UK-resident corporate partner would be assessed to tax on its share of the partnership's worldwide income, while a non-resident corporate partner will only be assessed to tax on its share of the profits of a trade carried on in the UK through a permanent establishment.

**Stamp duty and stamp duty land tax.** Regardless of the tax residence of the limited partner disposing of the interest, UK stamp duty is theoretically chargeable on the transfer of an interest in the partnership (as a separate chose in action) (*see paragraph 25094, HM Revenue & Customs' Inheritance Tax Manual and paragraph 6016, Trusts Manual*).

However, UK stamp duty is capped at the stamp duty which would be chargeable if the transfer was of the underlying assets of the limited partnership rather than of the partnership itself (*paragraph 33, Schedule 15, Finance Act 2003*). Accordingly, if the assets of the limited partnership include stock or marketable securities in a UK company, UK stamp duty will be chargeable on the transfer of an interest in that partnership, based on the value of the assets transferred. Where a limited partnership holds UK real estate, there are specific rules that impose a charge to stamp duty land tax on transfers of partnership interests.

winning bidder contractually agrees with the runner-up to grant it a 30% economic exposure to the fund interest through a joint venture arrangement that is invisible to the GP (*see "More complex structures" below*).

Different buyers will have different requirements for reaching a view on value. Some will be satisfied with a desktop valuation restricted to available financial and legal documents relating to the fund. Other secondary investors employ a highly detailed "bottom-up" approach, and seek to value each portfolio company and assess the likelihood of it reaching a successful exit. In most cases, the track record of the underlying fund managers is also a significant factor.

In the interests of time, the desktop approach to due diligence is attractive, as in the time it takes to carry out extra due diligence, the GP may issue further capital calls or categorise the seller as a defaulting investor, changing the nature of the interests being transferred.

A feature of the current secondaries market being over-supplied is the demands by buyers in auctions for cost coverage at the start of the due diligence phase. This would typically be in the form of a break fee or indemnity for a pre-agreed level of costs in favour of the bidder, payable if the bidder's offer is rejected at a later stage. While unpalatable for a seller to concede, this is sometimes the price it needs to pay to bring bidders to, and keep them at, the table.

GPs are, naturally, very sensitive about the confidential information which is shared between buyer and seller in the due diligence process. Valuing the various fund interests requires the disclosure of highly confidential information about each fund and its portfolio companies, which will invariably be prohibited by the confidentiality provisions in the LPA. Any due diligence should therefore be preceded by the execution of a full non-disclosure agreement, which should be written for the benefit of the GP (even if the GP is not made aware of the transaction until a later date). This helps to provide comfort to the GP and will minimise the risk of it refusing its consent to the transfer.

Where a fund of funds is purchasing the partnership interest, both the manager of the buying fund and its own investors will seek information on an ongoing basis as to the underlying funds' performance (and even the performance of the funds' portfolio companies). This may raise confidentiality issues, as the group of entities wishing to obtain this information may be broader than the group with whom the GPs of the underlying funds are comfortable.

### Sale and purchase agreement

Where more than one fund interest is being sold, the buyer and seller will typically enter into an umbrella, or framework, SPA. A consequence of the restrictions on transfer in the fund LPA is that signing of the SPA and completion will not be simultaneous (*see "Approaches" above*). Rather, the SPA will contemplate a completion (or, in the case of a portfolio sale, multiple completions) which will occur once the restrictions on transfer in the LPA have been satisfied or waived (for example, once the consent of the GP is obtained and the ROFR provisions, if any, have been complied with (*see "Approaches" above*)).

The SPA should contain a mechanism to carve out those interests that are taken up by other investors under the ROFR or those interests in respect of which the consent of the GP is not obtained.

The SPA will also contemplate individual assignment and assumption or other transfer agreements being entered into and exchanged at completion (the form of which will either be prescribed by the LPA or drafted with the assistance of the GP). The SPA will need to identify clearly what liabilities are being assumed by the buyer; for example, the liability to meet all future capital calls and the liability to contribute capital that has been returned but is still subject to recall (the latter being a liability which buyers tend to wish to avoid). The seller will be motivated to achieve a clean break.

In addition, thought must be given to the allocation of rights and obligations between the transferor and the transferee, particularly in relation to how ***clawback***, indemnification and other ongoing rights and obligations are split between the investor and its successor in interest (*for background, see feature article "Private equity funds: US and UK features", www.practicallaw.com/5-102-3098*).

**Warranties.** The SPA will also contain contractual comfort for the buyer regarding the quality of the interest being transferred, in the form of warranties. Seller warranties will cover a broad range of issues, including: title, capacity of the seller, no breach of LPA, no litigation or claims, and warrant of financial information provided by the seller in the diligence process. With regard to the warranty of financial information, buyers will typically request a certificate from the GP confirming the capital contributions paid by, and distributions made to, the seller during the time it held the interest. However, GPs are not always obliged or prepared to provide such comfort to a buyer.

As in a traditional M&A transaction, a seller will want to have the opportunity to disclose against the warranties. This will be particularly important for distressed or liquidity-constrained sellers, who may have to disclose irregularities in relation to meeting capital call notices during the months leading up to the sale. In these circumstances, there is often also a debate between the parties as to the repetition of the warranties at completion.

**Covenants.** Because the transfer of individual fund interests may take several weeks or months to achieve after the SPA is executed, the buyer will want to ensure that the seller's conduct in relation to the interests is both transparent and predictable. This can be achieved by including a series of pre-completion covenants by the seller in the SPA, to ensure that the value of the interests is preserved.

A material breach of pre-completion covenants or warranties (to the extent that they are repeated at completion) will typically give the buyer a right to rescind the contract.

### Transfer of interests

While the agreement for the sale of the fund interests in the form of the SPA is, in many ways, similar to an asset purchase agreement used in an M&A context, care should be taken to ensure that the correct procedures are followed to effect the actual transfer of the legal title to the fund interest. The LPA will often prescribe the form of transfer document to be used to effect the transfer of the legal title to the interest (*see "Sale and purchase agreement" above*). The GP will also usually be in a position to administer or oversee the transfer of the interest and the operation of any ROFR provisions. Consequently, both buyer and seller will need to have a close dialogue with the GP in the period before completion in order to ensure that the transfer proceeds as quickly as possible.

In some jurisdictions, legal or regulatory provisions governing limited partnerships prescribe the method and timing of the transfer of legal title to the limited partnership interest. For example, for the transfer of an interest in an English or Scottish limited partnership to be effective, a notice of the transfer must be published in either the London or Edinburgh Gazette, depending on the place of incorporation of the partnership (*section 10, Limited Partnerships Act 1907*).

In certain cases, transfers may trigger a US fund becoming classified as a "publicly traded partnership" (PTP) under US securities laws. The consequence of this is that the fund risks becoming separately taxable as a corporation (*for more information on taxation, see box "Taxation issues"*). However, safe harbours exist which permit certain transfers without the risk of PTP classification; for example:

- The private placement safe harbour. This requires the partnership to have no more than 100 partners at any time during its taxable year. It also requires all units of the partnership to have been issued in transactions that do not need to be registered under the US securities laws.

- The de minimis trading activity safe harbour. This provides that a partnership is not publicly traded if the sum of all interests transferred (other than through private transfers) during a tax year does not exceed 2% of the total interests in partnership profits or capital.

There are additional exemptions for certain transfers that are deemed not to involve trading.

## MORE COMPLEX STRUCTURES

There are often commercial, legal or tax issues that require a more complex structure than that of a standard secondary transfer. These include:

### Secondary direct

A "secondary direct" involves the sale of a captive portfolio of direct investments held by a private equity fund to a secondary buyer that will either manage the investments itself or arrange for a new manager for the investments. Secondary directs require the formation of a GP-like entity to manage, add value, and successfully exit the portfolio investments. The portfolio may be managed by the original management team that assembled it or by a new management team.

This structure differs from the traditional sale of limited partnership interests because it trades a direct investment in operating companies, rather than in the fund that holds that investment. This is frequently used to eliminate non-strategic assets, or as a "tail-end" transfer of remaining assets in a private equity fund that is approaching, or has exceeded, its anticipated life. A tail-end transaction allows the manager of the fund to accelerate liquidity for the fund's investors. As such, a secondary direct transaction provides an exit for all the fund's investors, as distinct from a transfer of an investor's interest, which provides an exit for that investor only.

From a tax perspective, a secondary direct transaction should have the same characteristics for the seller as any other exit performed by a private equity fund (*see box "Taxation issues"*). Stamp duty and other transfer taxes may also be payable on the disposal of the investment in the operating company.

### Stapled transaction

A stapled transaction is sometimes used where the GP of a fund is contemplating raising a new or follow-on fund. In exchange for providing its consent to the transfer of a fund interest by the seller, the GP extracts a commitment from the buyer to invest in the new fund. This type of transaction has, in recent years, been initiated by private equity firms during the fundraising process. It allows the GP to replace an existing investor which is unwilling (or unable) to make new commitments and to seed its new fund with investors. Previously, there has been a lot of negotiation around the size of the primary commitment taken on in addition to the secondary interest. However, current market dynamics have generally resulted in GPs no longer being able to impose the requirement for stapled transactions on secondary buyers, because the high volume of discounted secondary fund interests being marketed means that investors have limited appetite to commit resources to primary investments.

### Synthetic secondary

The "synthetic secondary" description covers a range of transactions where the purchaser acquires only the beneficial or economic interest in the underlying fund, rather than an actual transfer of legal title.

This may be done, for example, as a structured joint venture between buyer and seller, where the fund interests are transferred to a special purpose vehicle

## Key terms

***Capital call.*** When the general partner (GP) requests additional capital from the investors, up to each investor's agreed maximum. Usually the general partner will make a series of capital calls over time as opportunities arise to finance investments.

***Clawback.*** Clawback protection is given to investors to ensure that the order of distributions does not result in the GP receiving a carried interest distribution of net profits of the fund over its life in excess of its agreed percentage (usually 20%).

***Closed-ended.*** An investment fund which has a limited number of shares or units and a finite life. When the fund is established, the amount of capital to be invested is fixed. Units or shares in closed-end funds may usually be resold to other investors but generally cannot be redeemed by the fund until dissolution.

***Internal rate of return.*** A compound rate of return worked out over the life of a private equity fund reflecting both the investment return and the rate at which the return is produced. This is calculated by way of an iterative mathematical formula which values, at the date of exit, the cash spent by the private equity provider and cash returned. The internal rate of return is the discount factor which, when applied to these cash flows, produces a net present value equal to zero. It is broadly equivalent to a notional rate of compound annual interest earned on money invested.

***J-curve.*** Denotes the decline in value of early valuations of a private equity portfolio (relative to the capital the investor has contributed), followed by an increase in value after the initial years.

***Mark to market.*** A method of accounting. Marking to market means that the company's balance sheet shows loans and debt instruments at their fair value, which may be higher or lower than cost. Any profits or losses due to any change in value will go to the profit and loss account or to reserves.

***Portfolio manager.*** The manager of an investor's portfolio of limited partnership investments.

***Vintage year.*** The year in which a fund makes its first investment.

(SPV), the shares of which are held by the seller and buyer. This may be used to side-step transfer restrictions in the LPA, or where the seller only wants to reduce its overall exposure to the portfolio rather than selling it. A majority of funds do not yet specifically prohibit a synthetic transfer, so this structure can go some way to reducing the administrative burden of liaising with various GPs in the sale of a portfolio.

In another scenario, the ***portfolio manager*** may want to reduce its overall private equity exposure but still wish to maintain relationships with the various GPs. The portfolio manager may offer to sell a "horizontal strip" of its entire portfolio, for example contracting with the buyer to pass a 25% stake in a basket of fund interests, thereby maintaining relationships and also its weightings of investments in the various private equity sub-classes (such as venture capital, buyout or mezzanine funds), but reducing overall exposure. This could be structured through a jointly-owned SPV, or purely contractually through a total return swap arrangement (which transfers market risk as a whole).

As well as the advantages mentioned above, a key characteristic of a synthetic transfer is its speed of execution. However, transfer restrictions in the LPA do vary considerably and care should be taken to ensure that the proposed transaction is not prohibited.

*James Burdett is head of, and Gabriel Boghossian is an associate in, the Investment Funds Group at Baker & McKenzie LLP.*

## Related information

**Links from www.practicallaw.com and the web**

This article is at www.practicallaw.com/4-386-2640

### Topics

| | |
|---|---|
| Investment funds | www.practicallaw.com/6-103-1352 |
| Partnerships and LLPs | www.practicallaw.com/5-103-2045 |

### Practice notes

| | |
|---|---|
| Investment funds: overview | www.practicallaw.com/4-203-1837 |
| Investment funds: tax: introduction | www.practicallaw.com/3-382-5441 |
| Limited partnerships: tax | www.practicallaw.com/1-382-5442 |

### Previous articles

| | |
|---|---|
| Private equity funds: US and UK features | www.practicallaw.com/5-102-3098 |

*For subscription enquiries to PLC web materials please call +44 207 202 1200*