

RISK SOLUTIONS

GP-Led Secondaries:

What They Are, How They Work, and Why They're Not Going Away

January 12, 2023



Speakers



Proskauer >>

James C.H. Lee
Partner

James C.H. Lee is a senior partner in the Corporate Department and a member of our Private Equity and Mergers & Acquisitions Groups. James has extensive experience advising private equity funds, venture capital funds, private investment firms, high-net worth family offices, and their respective portfolio companies in a variety of domestic and cross border transactions, including mergers and acquisitions, leveraged buyouts, growth equity investments, secondaries, AIV structure transactions, recapitalizations, reorganizations, acquisitions and divestitures, and debt and equity security investments. His transaction experience is across a targeted spectrum of industries, including healthcare (medical devices/distribution and medical services) and digital healthcare, manufacturing/aerospace, industrial, industrial-tech and distribution, advertising technology, Internet of Things, SaaS based services, internet-based products and services, fin-tech, and oil and gas supply-chain and related services.

In addition, James advises senior executives, senior advisors, boards of directors, and private equity funds on corporate governance matters, portfolio company operations and management, and executive compensation arrangements and separations. He also advises private equity funds in connection with fund formation, launch and management matters, and advises private investment funds in the formation, offering and management of special purpose investment vehicles, including pledge-capital arrangements.

Recognized by Legal 500, "New York's James Lee is exceptionally hard working, responsive and knowledgeable."



 **Brown & Brown**

Joe Ehrlich
National Practice Leader

Joe Ehrlich serves as Brown & Brown's National Practice Leader for Private Equity, Family Office and M&A. Joe has experience identifying, structuring and providing insurance products and solutions for private equity firms, family offices and other investors, individuals and companies.

Prior to joining Brown & Brown, Joe was the President of the Owens Group, where he primarily focused on private equity, family office and M&A insurance solutions. Prior to joining the Owens Group, Joe practiced corporate private equity and M&A law at O'Melveny & Myers LLP and its predecessor, O'Sullivan Graev & Karabell LLP.

Joe holds a Bachelor of Arts in Classics from Columbia University, and he received his Juris Doctor degree from New York University's School of Law. Joe is also a member and the immediate past president of the NYU Law Alumni Association Board and frequently presents to professional groups and organizations on insurance-related topics.

Speakers



ROPES & GRAY

Isabel K.R. Dische
Partner

Asset management partner Isabel Dische co-leads Ropes & Gray's institutional investors team. Ranked globally by Chambers Global for investment funds, she primarily focuses on advising asset managers and institutional investors on matters that span alternative asset classes. Among the clients she counsels are ten of the top 15 secondary buyers and sovereign wealth funds across the globe, including Australia, Canada, China, Japan, the Netherlands, Nigeria, Singapore, and South Korea.

Isabel is especially skilled at structuring legally complex transactions and is known for “thinking creatively,” being “commercially smart,” and providing “incredibly thoughtful” advice, as clients have told Chambers. With experience as both a funds lawyer and a deal lawyer, Isabel is able to offer a unique perspective when advising clients.

Isabel's keen sense of the market is grounded in her representation of both fund sponsors and investors, and in the sheer volume of her practice. Her team was named the number one legal adviser by global secondaries deal count in 2019 and 2020, according to Secondaries Investor. In 2022, the team closed more than 450 secondaries transactions worth over \$146 billion and over 400 co-investment transactions.

In addition to her work with institutional investors, Isabel advises hedge funds and other private funds and their sponsors on fund formation, legal and risk management questions, and firm ownership and operations. She started her career as an associate at Atlas Venture, which one client notes “adds to her insight of how [funds] operate.” She also counsels investment advisers and institutional investors on environmental, social and governance (ESG) and responsible investing.



**NEW 2ND
CAPITAL**

Evert Vink
Partner and COO

Evert Vink is a Partner and the COO at New 2ND Capital in New York. New 2ND Capital is a private equity firm that invests in North American middle market companies through GP-led secondaries investments. Prior to joining New 2ND Capital, Evert Vink was at AlInvest Partners in New York (Carlyle's solutions group) for 15 years, where he worked on numerous secondaries investments as well as primary fund investments in the Americas. At AlInvest/Carlyle, Evert Vink was involved in the raising of multiple commingled private equity funds and separate managed accounts totaling over \$20 billion.

He is a member of the investment committee of the endowment of Friends Seminary, a K-12 day school in New York City. Evert started his career with Freshfields in Amsterdam and Simpson Thacher in New York. He has a law degree from the University of Amsterdam and an MCJ degree from the New York University School of Law.

Presentation Agenda



1

An overview of the GP-led Secondary

2

Trends relating to GP-led Secondary strategy adoptions

3

What has driven the growth of the GP-led Secondary market?

4

The benefits of GP-led Secondaries

5

What is the typical structure of a GP-led secondary transaction?

6

What is the typical process of such transaction and what roles and potential conflicts could the stakeholders have?

7

The legal and other challenges of GP-led Secondaries

8

The future of GP-led Secondaries

01

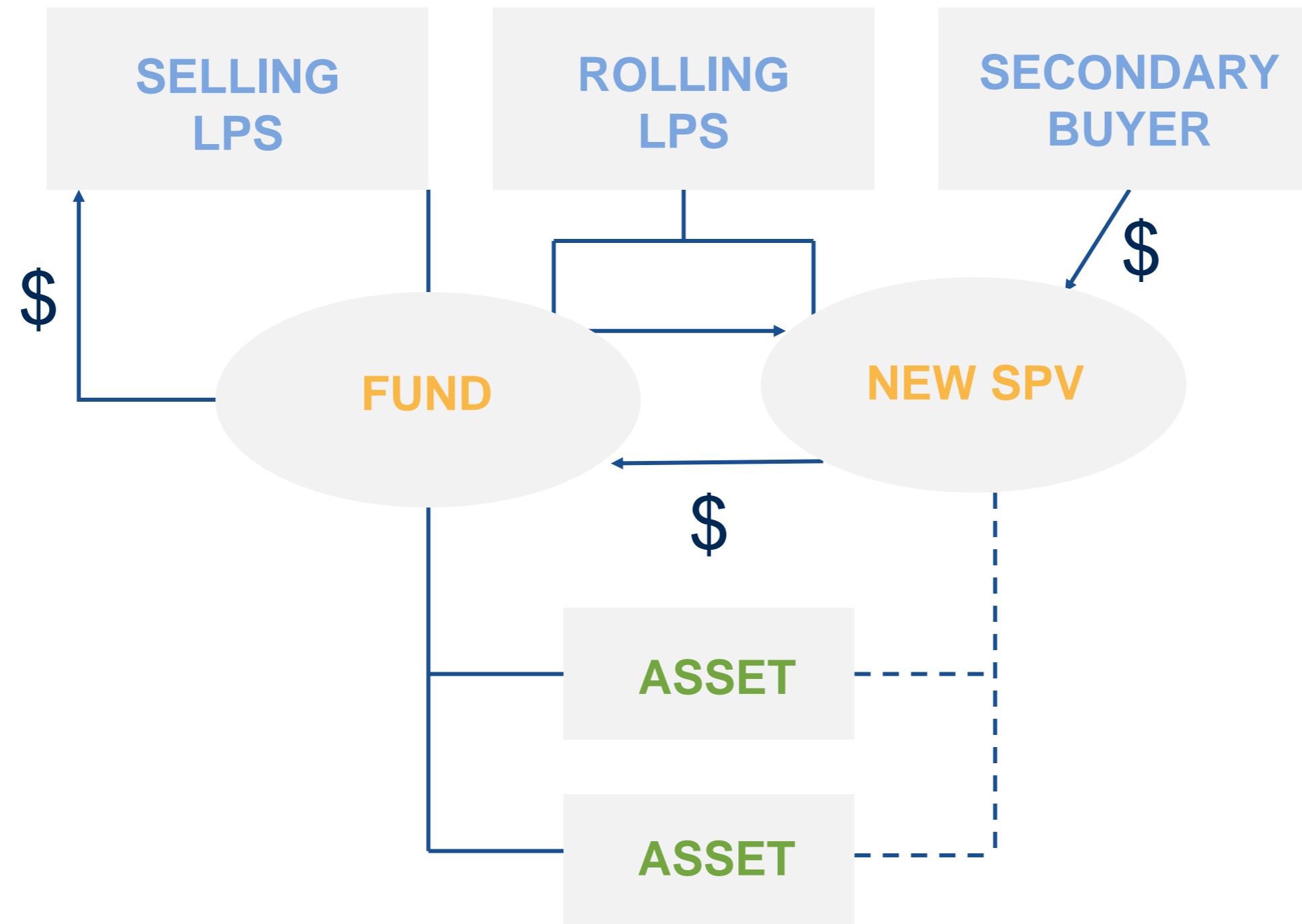
Overview of GP-Led Secondaries

What is a GP-Led Secondary Transaction?

- ➔ A GP-led secondary is a transaction in which a financial sponsor (or 'general partner') sells one or more of its investments/companies from one fund that it manages to another fund that it manages.
- ➔ The new fund is frequently referred to as a 'continuation vehicle.' The continuation vehicle is managed by the same financial sponsor/general partner.
- ➔ The general partner is generally capitalized by one or more secondary buyers.



Continuation Fund – Transaction Structure



Continuation Fund – Rationale, Pros & Cons

RATIONALE

- Provides additional time to maximise value of assets with potential follow-on capital
- Solution for older vintage fund(s) nearing term expiration, providing liquidity to investors
- Crystallise fund returns
- GP continues to manage assets
- Full/partial liquidity to former/current employees no longer involved in management of fund
- Full/partial liquidity to existing LPs.

PROS

- Term extended and follow-on capital provided
- Can negotiate new economic terms
- Non-responders deemed selling LPs
- GP can choose assets to transfer
- Re-incentivise current active management team members
- Allows GP to hold on to investments that they know and believe to have additional value creation opportunities rather than trade it for an unknown entity

CONS

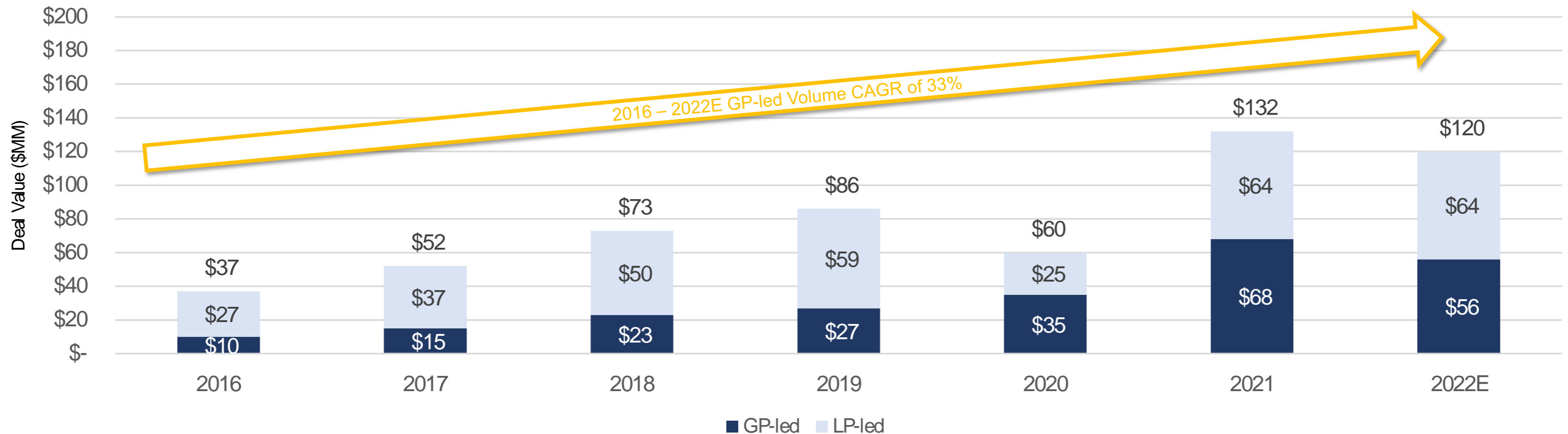
- Conflicts
- Complexity
- Cost
- Requires asset level diligence

02

Market Trends

Private Equity Secondaries Market

Global Secondary Transaction Volume



1. 2016 – 2021 are based on New 2ND Capital's analysis using market reports by Evercore (2021 YE Secondary Market – Jan 2022), Raymond James/Cebile (H2 2021 Outlook Secondary Survey) and Jefferies (Global Secondary Market Review – January 2022)

2. 2022E is an estimated based on annualized H1 2022 volume as reported in Lazard's Sponsor-Led Secondary Market Report H1 2022.

The statements provided on this slide are based on New 2ND Capital's subjective view and experience and subject to change. There can be no assurance any trends described on this page will persist. Forecasts are inherently uncertain and subject to change

What Is Driving GP-led Growth?

GPs' perspective

Maturation of the asset class

- » Increasing number of funds coming to the end of their life, needing liquidity solutions for remaining assets
- » There is no longer stigma associated with a GP-led transaction¹

Continuation funds have become a new viable exit alternative

- » To generate liquidity for funds; and are regularly used by healthy vehicles for trophy assets earlier in the fund life
- » To raise follow-on capital when funds are “tapped out”

LPs' perspective

“Liquidity Squeeze” in private equity

- » Record capital deployment coupled with slower exit activity; private equity likely to generate negative cashflows in 2022
- » Robust private equity fundraising driving liquidity demand from LPs to redeploy capital

Based on New 2ND Capital's market observations, Debevoise & Plimpton (2021/2022 Private Equity Year-End Review and Outlook) and Lazard's Sponsor-Led Secondary Market Report H1 2022. The statements provided on this slide are based on N2C's subjective view and experience and subject to change. There can be no assurance any trends described on this page will persist. Forecasts are inherently uncertain and subject to change

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Stakeholders and Key Sponsor Risks

Continuation Fund – Stakeholders in the Transaction

Sponsors

- Extended duration to optimize value of high performing assets
- Additional capital to support existing portfolio/investments
- Crystalize carry for GP/IRR for Fund and LPs
- Reset incentive economics
- Reset carry arrangements between executives who left and those who are still with the GP
- Sometimes seen as a solution to tail end assets

Existing LPs

- Current liquidity vs. future upside (what is being left on the table?)
- Ability to assess opportunity: roll or sell? Status quo offered?
- Conflicts of interest (what is GP receiving?)
- Internal allocation/portfolio management
- Proposed structure and economics

Buyers

- Access to a mature portfolio with unrealized upside
- Maximize return potential from IRR and multiple perspective
- Create GP/LP alignment that is not traditional 2/20
- Will there be a critical mass of selling LPs?
- How will GP manage conflicts and existing LP base?
- How much due diligence is possible/expected?
- Unfunded commitment requirements for follow-ons and fees and expenses

04

Process & Documentation

Indicative Timeline: GP Led Transaction

Typically 3-6 months (for buy side)

Buy side due diligence:

- Review of any relevant publically available information or any teaser presentations
- Selling fund analysis and key metrics
- Change of control analysis: portfolio company equity & credit agreements, material litigation, regulatory issues, employee compensation matters, co investor rights, commercial contracts, etc.
- Investor tax / ERISA considerations

Consider if desirable:

- If so, start process early
- Agree allocation of cost and scope of coverage
- Consider exclusions

Key documentation:

- Term Sheet
- Rep & Warranty Outline
- Contribution Agreement / Master Framework Agreement
- New Fund LPA Side Letter
- Confidential Information Memorandum

Closing:

- Closing occurs once conditions have been satisfied (including regulatory consents and Approvals)
- Payment of Purchase Price



Process run by **Secondaries Advisor**

Investors to consider:

- Appropriate pricing, including impact of any fairness opinion process
- Syndication process
- Process, number of rounds involved
- Acquisition finance

Determine/confirm required **LPAC and/or investor approvals, as well as any third-party approvals**

Existing LPs decide whether to exit or roll

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Key Sponsor Considerations

Key Sponsor Risks

CONSIDERATION	COMMENTS
Fiduciary duties and conflicts of interest	<ul style="list-style-type: none"> • Potential for intense scrutiny after-the-fact by aggrieved LPs and regulators • Status quo option provided to existing LPs? • Equal access to diligence in the dataroom? • Fairness or valuation opinion provided to existing LPs? • Improvement in GP economics?
LPAC/LP consent	<ul style="list-style-type: none"> • LPAC consent will typically be required given sponsor conflicts • LP consents/amendments may also be required • Buyer should confirm with the sponsor that consent requirements have been satisfied early in the process to avoid “dead end” deals
Tax Structuring	<ul style="list-style-type: none"> • Consider whether blockers are being purchased or inserted • Consider potential withholding taxes and how they will be addressed • Impact of QSBS on structuring • Holding period
Regulatory Considerations	<ul style="list-style-type: none"> • Discuss potential deal impediments with sponsor (e.g., anti-trust, CFIUS, SEC, FCC)

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Key Fund Considerations

Key Fund Terms – Commitments & Purchase Price

CONSIDERATION	COMMENTS
Allocation Waterfall	<ul style="list-style-type: none"> • Allocation “Flow”: how much of the deal will be allocated to and among the leads prior to syndication to other buyers/investors, and who receives any excess? • Floor and Ceiling: minimum transaction value and/or cap for participation? • Deviation: minimize sponsor’s ability to deviate from the allocation waterfall
Purchase Price	<ul style="list-style-type: none"> • Purchase price adjustment: increase PP for contributions made after the reference date; decrease PP for distributions made after the reference date • Portfolio Fees: adjustment for post-valuation date portfolio fees paid to the sponsor? • Currency Conversion: calculation and timing (e.g., conversion at record date or at closing)? • Tax Withholding: sellers should bear any withholding taxes
Buyer Commitment	<ul style="list-style-type: none"> • Unfunded Commitments: confirm whether all rolling investors will take on their portion of unfunded commitments; if not consider whether there should be some sort of ratio or cap • Follow-On Investment Consent: lead investor consent? • Expenses: confirm expenses are within unfunded commitment (or otherwise capped)
Sponsor Commitment	<ul style="list-style-type: none"> • GP Rollover: market traditionally 100% of capital and crystallized carry of active GP members, but shifting in recent “blue chip” deals • GP Follow-On Requirement: confirm GP will be participating pro rata for alignment

Key Fund Terms – Expense Sharing

CONSIDERATION EXPENSE “BUCKETS”	COMMENTS
Seller Expenses	<p>Not typically borne by Continuation Fund:</p> <ul style="list-style-type: none"> • LPA amendments; LPAC consents; LP consent solicitation and election forms • Fairness or valuation opinions • Placement agent and professional advisor fees and expenses to the extent relating to the M&A transaction
Transfer Expenses	<p>Often split in an equitable manner (e.g., 50/50) between Sellers and Continuation Fund:</p> <ul style="list-style-type: none"> • Portfolio company transfer expenses • Regulatory expenses (e.g., HSR filings) • Contribution/PSA expenses • Cost of rep and warranty insurance • Transfer taxes relating to “sold” interests
Continuation Fund Expenses	<p>Often borne by Continuation Fund:</p> <ul style="list-style-type: none"> • Organizational expenses (typically subject to a cap) • Lead investor expenses (typically subject to a cap) • Placement agent fees relating to new commitments to the Continuation Fund (subject to management fee offset)

Key Fund Terms – Economics & Cashflows

CONSIDERATION	COMMENTS
Distribution Waterfall	<ul style="list-style-type: none"> • Carried interest: typically bespoke with multiple performance tiers (MOIC and/or IRR hurdles) • GP Clawback: confirm appropriate Clawback protection • Clawback guarantees: confirm sponsor carry recipient guarantees and enforceable by lead investors • Whether RWI proceeds are paid inside or outside the waterfall is a negotiated point • Tax distributions on rolled GP interest (i.e., 704(c) allocations)
Management Fee	<ul style="list-style-type: none"> • Calculation: often based on step-down rate of selling fund (i.e., cost basis of unrealized investments, not commitments). Consider further reduction for write-downs. • Offset: 100% portfolio fee offset? If agent fees borne by Continuation Fund, 100% offset? • Termination: fee should terminate upon expiration of the term
Recycling and Reinvestment	<ul style="list-style-type: none"> • Caps: confirm caps and time limits on recycling usage for both investments and expenses

Continuation Funds – Dilution & Governance

CONSIDERATION	COMMENTS
Dilution Considerations	<ul style="list-style-type: none"> • Non-pro rata rollers: confirm appropriate dilution mechanic for rollers opting out of follow-on requirements • Closing: confirm limits on admission of post-closing LPs • Follow-on investments: confirm that Continuation Fund receives priority (or pro rata share with other investing sponsor funds) with respect to any follow-on opportunity • Co-investment rights: avoid dilution if no remaining unfunded (preemptive rights may also be considered)
Other Governance Considerations	<ul style="list-style-type: none"> • Term and extensions: typically 3 to 5 years plus two 1-year extensions with LPAC approval • Borrowing: subscription line only, or otherwise limited? • LPAC: participation rights, voting methodology and liability protections • Special lead investor rights: often lead investors will have special approval rights • GP removal rights: for cause and/or no fault? Often similar to existing fund removal rights • Key person: useful if follow-on investments contemplated • ROFR: lead investor priority on secondary transfers? • Side letter: lead investor typically receives MFN and standard side letter rights

07

Key Transaction Considerations

Key Transaction Considerations

CONSIDERATION	COMMENTS
Source of Recovery	<ul style="list-style-type: none">• Holdback/Deferral. The sole source of recovery for any “Non-Fundamental Representation” is limited to the holdback or deferral amount. Market Range is: 5% - 15% of the purchase price, with recent trends moving towards the lower end of the range.• LP Clawback Provisions. Require enforcement by the sponsor of LP Clawback obligations in respect of LPs who received liquidity. Ensure that pre-transaction structuring does not limit Buyer’s ability to enforce LP clawback.• Representation and Warranty Insurance. In the past 2 years, there has been an increase in the use of representation and warranty insurance. Typically, sponsors will encourage the use of such insurance policies as it alleviates the selling funds’ continuing indemnity obligations. Buyers and selling LPs will typically share the cost of such insurance policies, with the Buyers’ contribution capped at a certain amount. If representation and warranty insurance is obtained, new investors need to be careful in how the policy interacts with the indemnity provisions in the purchase agreement and how claim proceeds are treated under the waterfall.• Recovery Challenges. Ability to recover against selling LPs may be difficult due to limitations in the transferring fund’s governance documents.

Key Transaction Considerations

CONSIDERATION	COMMENTS
Caps / Deductibles / Thresholds	<ul style="list-style-type: none">• Non-Fundamental Reps; Tipping Basket v. Deductible: Recovery from dollar one once a certain threshold has been met v. recovery in excess of that threshold.• Non-Fundamental Reps; Cap: Cap limited to amount in holdback/deferral amount.• Fundamental Reps; Cap: Cap limited to purchase price; however, in large-cap transactions, recent trends have been moving towards a lower agreed-upon cap amount (e.g., as low as 30% of the purchase price).• Excluded Liabilities; Cap: Cap limited to purchase price; however, in large-cap transactions, recent trends have been moving towards a lower agreed-upon cap amount.• Fraud Cap: Cap generally limited to purchase price; however, in lower or mid-cap transactions, parties may agree to no cap for fraud-based claims.

Key Transaction Considerations

CONSIDERATION	COMMENTS
Representation and Warranties; Survival	<ul style="list-style-type: none">• Fundamental Representations and Warranties. (1) customary fundamental representations (e.g., title to shares of the portfolio company) and (2) certain knowledge-based representations related to matters in respect of the applicable portfolio companies (e.g., knowledge-based debt and equity capitalization of the applicable portfolio company).<ul style="list-style-type: none">» Survival: Statute of limitations, but in no event less than 6 years; however, recent trends in mid/large cap transaction is to mutually agree to a shorter period (3-5 years). Note, if obtaining RWI the term is 6 years.• Non-Fundamental Representations and Warranties. (1) knowledge-based representations related to the applicable portfolio companies (e.g., no litigation) and (2) non-knowledge-based representations related to the applicable portfolio companies (e.g., representations regarding delivery of financials).<ul style="list-style-type: none">» Survival: Later of the (1) one-year anniversary of the closing (which can often range up 18 months) and (2) 60 days following the delivery of audited financials for the year in which closing occurs. Note, if obtaining a RWI policy, the term is 3 years.

Key Transaction Considerations

CONSIDERATION	COMMENTS
Representation and Warranties; Survival (cont'd)	<ul style="list-style-type: none">• General Partner Representations and Warranties. As the general partner will be a party to the applicable purchase agreement, the general partner is required to make certain “Fundamental Representations” in respect of itself and representations being made by the applicable funds.<ul style="list-style-type: none">» Survival: Generally the same as the survival periods for “Fundamental Representations” and “Non-Fundamental Representations” based on the applicable representation being made by the general partner.• Cure Provisions. In respect of certain representations, it has become “market” that the sponsor has the ability to update representations for certain events that arise after the signing (subject to dollar thresholds and other qualifiers). In most cases, the update will not have an impact on the closing conditions but would cure any indemnity obligations.

Key Transaction Considerations

CONSIDERATION	COMMENTS
Excluded Obligations / Tax Liabilities / Fraud; Survival	<ul style="list-style-type: none">• Excluded Obligations. In general include (1) legacy liabilities of the applicable fund, (2) any matters (including tax) related to assets of the applicable fund not being acquired, (3) certain excluded tax liabilities, and (4) any specific liabilities/obligations identified during due diligence (e.g., environmental liabilities).<ul style="list-style-type: none">» Survival: Indefinite survival; however, recent trends in mid/large cap transactions is to mutually agree to a date certain (ranging from 3-6 years, which based on the competitiveness of the potential transaction trends towards the lower side of range).• Excluded Tax Liabilities. Generally, (1) pre-closing taxes of the sellers and selling fund (including successor tax liability imposed on the continuation fund), (2) transfer taxes, (3) FIRPTA/ECI withholding, and (4) certain pre-closing taxes imposed on an audit.• Fraud. Fraud should be included as an indemnifiable claim.<ul style="list-style-type: none">» Survival: Indefinite survival; however, recent trends in mid/large cap transactions is to mutually agree to a date certain (ranging from 3-6 years, which based on the competitiveness of the potential transaction trends towards the lower side of range).

Key Transaction Considerations

CONSIDERATION	COMMENTS
<p>Customary Closing Conditions</p>	<ul style="list-style-type: none"> • General: Generally, the closing conditions are more limited than those in a purchase agreement to directly acquire a portfolio company. • Customary Examples of Closing Conditions: <ul style="list-style-type: none"> » Receipt of all anti-trust/competition approvals. » Representations and warranties are true both as of the signing date and the closing date. » No portfolio company is in default of any financing arrangement, nor is any portfolio company reasonably expected to be in default. » Required approval of applicable limited partners. » Required level of financial commitment by sponsor. » Tax forms/certifications required to reduce/eliminate FIRPTA/ECI withholding.
<p>Tax Covenants</p>	<ul style="list-style-type: none"> • General: Generally include (1) 754 election, (2) for fund & any pass-through portfolio companies, election to push-out tax liability to former partners of fund, (3) closing of the books for any pre-closing tax period, and (4) purchase price allocation.

Key Transaction Considerations

CONSIDERATION	COMMENTS
Additional Items for Consideration	<ul style="list-style-type: none"><li data-bbox="959 540 2902 690">• Definition of “Knowledge Parties”. As a material set of the representations and warranties will be “knowledge” qualified, it is important to both (1) identify the appropriate individuals, who should serve as Knowledge Parties and (2) establish a “due inquiry” standard.<li data-bbox="959 789 2902 883">• Indemnity/New Investors. Subject to specific circumstances of the transaction, in certain cases, one will need to ensure that only “new investors” in the Continuation Fund are entitled to indemnity proceeds.<li data-bbox="959 983 2902 1076">• Antitrust Filings. Anti-trust analysis of all applicable jurisdictions should be completed as soon as possible to determine whether there are any issues to address, and to obtain certainty on timing of closing of the transaction.<li data-bbox="959 1176 2902 1326">• Disclosure Schedules. In consideration of the limited due diligence undertaken on the portfolio companies, it is necessary to ensure that Lead Investors are aware of and comfortable with the disclosures being made against the representations and warranties and to discuss the same with the Sponsor.

08

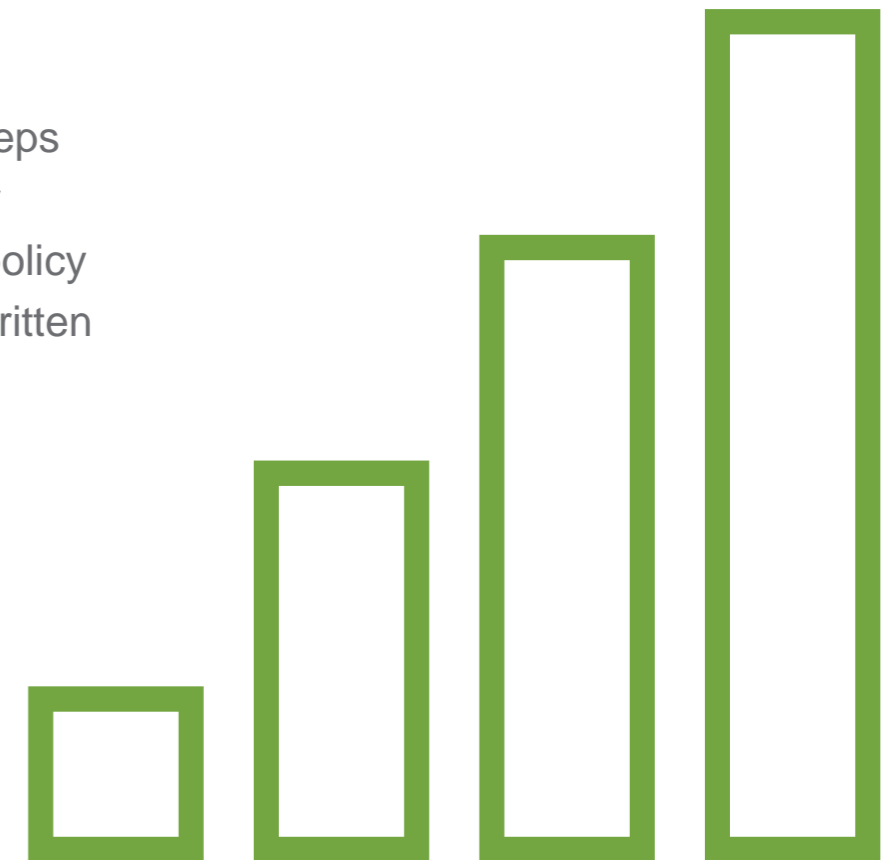
Representations & Warranties Insurance

R&W Insurance Introduction

- An insurance policy purchased in connection with an M&A transaction, which pays for losses in the event that a breach of a representation or warranty contained in the purchase agreement is discovered post-closing
- Either replace or supplement typical indemnity and becomes the buyer's primary or only source of recovery
 - Coverage generally survives for 6 years (3 years for breaches of non-fundamental reps)
- In a GP-led restructuring, R&W insurance covers losses incurred by the continuation fund
 - Covers 100% of Loss at the level of the New Fund (including GPs and existing LPs)
 - R&W insurance is primarily designed for "new money," but coverage may also be available for GPs and existing LPs
- In an M&A or real estate deal insurance covers buyer's losses
- The coverage is provided by "A" rated insurance companies.

Tiers of Coverage

- **Tiers of Coverage:** Variety of options for purchasing insurance coverage with pricing varying depending on the coverage
 - » **True Fundamental Representations:** Typically covering only standard fundamental reps, but can negotiate to expand to match purchase agreement
 - » **General Representations:** All reps made in purchase agreement other than fundamental reps including where relevant reps related to asset
 - » **Tax Representations:** Typically, all tax reps. Also, may (depending on diligence) cover Tax Indemnity/Synthetic Tax Indemnity
 - » **Excluded Obligations:** Negotiated set of Excluded Obligations as set forth in purchase agreement and subject to underwriting/diligence by insurer and counsel
- **Limit of Liability:** 10% to 20% of the enterprise value is customary for breaches of the general/tax reps with possibility of purchasing up to 100% for breaches of fundamental reps. Generally, coverage amount aligns with standard indemnity
 - » Top end of coverage potentially \$1B (exclusive of for Excluded Obligations) with another potential \$1B for true fundamentals coverage
- **Coverage Generally:** Insurers will cover the reps as drafted in the purchase agreement but may deem certain reps revised for purpose of the policy (e.g., adding knowledge qualifiers to reps or written qualifiers, carving out non-customary reps)



Cost of Coverage

- ➔ **True Fundamental Reps Coverage:** Can purchase coverage for just the fundamental reps in any M&A deal for ~1% of coverage limits
- ➔ **Typical Buyout Deal:** Premiums range from 3.00% to 3.75% of the policy coverage limits with premium rates higher for deals with “towers” of coverage but average downward because of ILF for additional layers
- ➔ **True Real Estate Transactions:** Premiums range from 2.00% to 2.50% of the policy cover limits
- ➔ **True Secondary Transactions:** Premiums range from 2.00% (for just fundamental reps coverage) to 3.25% (for full breadth of coverage including for Excluded Obligations)

Other Costs for R&W Insurance

01.

INSURANCE BROKER

Engage with insurance broker early on to help guide process and go to market but no up-front fee for broker to get initial indications from insurers

02.

UNDERWRITING FEE

\$40,000 to \$60,000 non-refundable diligence fee generally required to get insurer engaged. Non-refundable and not credited towards premiums

03.

RETENTION AMOUNT

Typical retention of approximately 1% of purchase price/enterprise value of the target/acquisition, though the trend has been toward lower retention. Retentions also are typically lower for true real estate deals (typically 0.25% of EV). Also, larger deals (over \$500M) tend to have lower retentions.

04.

PREMIUM DEPOSIT

When there is a separate sign and close, carriers will typically incept as of the signing subject to receipt of a 10% non-refundable deposit Premium. In this event, the policy will exclude interim breaches, but cover breaches that occurred pre-signing and are discovered between signing and closing.

R&W Insurance Underwriting Requirements

(SECONDARY TRANSACTIONS)

- In secondary transactions, the insurers are significantly more flexible in their underwriting requirements than in classic M&A transactions:

	CLASSIC M&A AND RE TRANSACTION	GP-LED SECONDARY TRANSACTION
Buyer's Role	<ul style="list-style-type: none"> Diligence Intense: The insurer expects the buyer to diligence all significant areas of potential risk, including legal, financial and tax. 	<ul style="list-style-type: none"> Diligence Light: The insurer understands that buyers typically conduct limited diligence in secondary transactions. The insurer strives to underwrite within the confines of the buyer's diligence.
Seller's Role	<ul style="list-style-type: none"> Limited to providing responses to insurer's diligence follow-up questions provided through buyer 	<ul style="list-style-type: none"> The insurer expects the seller/GP to be a key source of information. The seller/GP to provides information and participates in the underwriting call (the overall time commitment is minimal).
Insurer's Role	<ul style="list-style-type: none"> Passive: entirely reliant on buyer's diligence. 	<ul style="list-style-type: none"> Active: proactively works to obtain necessary underwriting information from a combination of the data room; sellers/GP and their advisors; and buyers and their advisors, all while taking into account actuarial / statistical data to avoid unnecessary/unreasonable exclusions.
Lack of Diligence	<ul style="list-style-type: none"> Automatic grounds for exclusion. 	<ul style="list-style-type: none"> Not, in itself, grounds for exclusion.

Timing Considerations

- Engage insurance broker early and enter into NDAs with broker and insurers
- Only one broker can be in market on any given deal
- Confirm level of coverage and negotiate terms with insurer(s)
- Align with GP's counsel on diligence and GP No Claims Declaration
- Commit to paying insurers' non-refundable underwriting fee (~\$40-60k)
- Determine whether able to pay required 10% insurance premium non-refundable deposit at signing or able to push back to Closing
- Underwriting Questions to be answered predominately by GP and GP's counsel
- Underwriting Call with all parties
- Follow-up questions to be answered predominately by GP and GP's counsel
- Negotiation of R&W insurance policy
- Provide updated turns of purchase agreements and disclosure schedules
- Binding of R&W insurance policy simultaneously with signing/going hard on deal

Contact Information



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