

Secondary Transactions and Financial Opinions, What You Need To Know!

BY: Scott Rogers, Senior Manager

Advisor, or General Partner (“GP”) led, secondary transactions are initiated by a GP in order to retain ownership of one or more assets. These transactions are likely seen when: (i) a GP sees value beyond the current fund life, expecting to realize more value in the future; (ii) a portfolio company may have postponed its growth plans; or (iii) market conditions are not favorable for limited partner (“LP”) exits. In this type of transaction, LPs can either sell to a new group of investors or roll over their investment into the new fund managed by the sponsor.

Proposed SEC Reforms

The robust growth and dollar volume in advisor-led secondary transactions has led to increased scrutiny and proposed regulation, specifically from the Securities and Exchange Commission (“SEC”). Since the proposed regulatory changes are not yet final, obtaining fairness opinions for GP-led secondary transactions still remains a best practice, and not a regulation. However, the proposed rules provide insight into the focus of the SEC on advisor-led secondary transactions.

Below are some recent developments on this front.

- On February 9th, 2022, the SEC voted to propose changes to the Investment Advisors Act of 1940 (“Advisors Act”) to enhance the regulation of private fund advisers and protect private fund investors by increasing transparency, competition, and efficiency in the \$18.0 trillion marketplace.
- On May 9, 2022, the SEC reopened the comment period, extending it through June 13, 2022, and solicited additional comments from the public.

While the SEC’s proposed changes are extensive, one substantial new rule would be the requirement of a fairness opinion by an independent third-party advisor for advisor-led secondary transactions. The proposed rule is meant to provide a check against conflicts of interests in adviser-led secondary transactions. Specifically, the SEC’s proposed rule stated:

“We propose to require an adviser to obtain a fairness opinion in connection with certain adviser-led secondary transactions where an adviser offers fund investors the option to sell their interests in the private fund, or to exchange them for new interests in another vehicle advised by the adviser.”

This would provide an important check against an adviser’s conflicts of interest in structuring and leading a transaction from which it may stand to profit at the expense of private fund investors.

The proposed adviser-led secondaries rule would prohibit an adviser from completing an adviser-led secondary transaction with respect to any private fund, unless the adviser distributes to investors in the private fund, prior to the closing of the transaction, a fairness opinion from an independent opinion provider and a summary of any material business relationships the adviser or any of its related persons has, or has had within the past two years, with the independent opinion provider.



What Do the Proposed Regulations Mean?

While obtaining a fairness opinion for secondary transactions has been considered best practice for some advisors, the SEC-proposed rule would mandate a fairness opinion in connection with adviser-led secondary transactions. A fairness opinion helps demonstrate an objective evaluation of the transaction, ensures that a thorough process has been undertaken, and provides protection of stakeholders' interests for all parties.

Empire's Financial Opinions Group

Empire Valuation Consultants has grown into one of the nation's leading and most respected independent valuation consulting firms, preparing 45,000 valuations over its 30-year history. While fairness opinions are widely sought for public company mergers and acquisitions, they may also be prepared for a wide range of public and private company transactions, both on the buy-side and sell-side, for situations such as the ones described in this article. The team of experts at Empire Valuation Consultants has established a track record as a leading transaction advisor and opinions provider. These opinions help companies, funds, and advisors understand and maximize value. If you lead or influence companies or funds undergoing a secondary market transaction, our team of experts is here to help simplify the complexities of the transaction by delivering the financial opinions that create sustainable value.



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