

INSIDE THE DEAL

Rise Of The Secondaries

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The private equity secondary market continued on a path of steady growth in 2012, a trend that is expected to persist throughout 2013 according to a recent report by Preqin, the alternative assets intelligence firm. Moreover, as the secondary market has grown, limited partner perception of secondaries has improved. This has caused and will

continue to cause a feedback loop that we think will only accelerate the trend.

There are a number of market dynamics fueling the growth in secondaries. On the sell-side, investors continue to sell their limited partnership interests for a variety of reasons, including for liquidity, to obtain relief from future capital calls, to address regulatory requirements, or to rebalance or diversify a portfolio.

On the buy-side, acquiring limited partnership interests in the secondary market presents investors with a number of potential advantages over acquiring interests in a primary market offering.

The secondary market offers greater transparency because funds with interests available in the secondary market often will have already made capital commitments, thus allowing investors to evaluate their underlying portfolios and mitigate some of the blind pool risk associated with a primary market investment. In addition, some funds available in the secondary market are at or near the end of their investment period, resulting in a shorter overall holding period and shorter time before distributions are made.

JOBS Act Impact

Another factor on the horizon that we think will further accelerate growth in private equity secondaries is the Jumpstart Our Business Startups Act of 2012. As a result the Securities and Exchange Commission will soon (though don't ask us to wager on how soon "soon" will be) lift the ban on general solicitation and general advertising in certain private securities offerings.

By way of background, the SEC first proposed amendments to lift the ban on general solicitation and general advertising back in August 2012; however, it has yet to finalize those amendments. In the interim, then Chairman **Mary Schapiro** resigned in December 2012, and **President Barack Obama** designated Commissioner **Elisse Walter** as her replacement. Shortly thereafter, Obama nominated **Mary Jo White**, formerly the United States Attorney for the Southern District of New York and later an attorney in private practice, to be the SEC's 31st Chairman. Now that White has been sworn into office, the SEC is expected to move forward expeditiously with the many rulemaking initiatives outstanding under

both the JOBS Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act. Indeed, in her prepared testimony before the Senate Banking Committee, White emphasized the need "to finish, in as timely and smart a way as possible, the rule-making mandates contained in the Dodd-Frank Act and the JOBS Act."

Following elimination of the ban on general solicitation and general advertising, in whatever form the rule amendments take, private offerings will become more public-like and there will be a growing awareness of the private equity markets. This awareness is likely to lead to a new mix of LPs participating in the primary market and, over the course of the next several years, to additional supply and demand in the secondary market.

Finally, growth in the secondary market has also led to an increasing number of secondary brokers, qualified matching services, alternative trading systems and other similar platforms. Even public exchanges like NASDAQ OMX are beginning to recognize the immense potential of private secondary markets. On March 6, 2013, NASDAQ and SharesPost, a private capital markets platform, announced that they would join forces to create a new market for private company shares, The NASDAQ Private Market. Pending regulatory approval, the NPM will launch a Web-based trading platform later this year.

Many questions remain, the predominant one being: What will this mean to fund sponsors? The secondary market is undoubtedly maturing and the potential influx of new investors, funds, and platforms will only serve to accelerate the process. Will a more robust secondary market mean less demand from LPs willing to invest on a primary basis? Can the potential influx of new investors offset any wane in demand from existing investors? Will fund structures have to change in response to a more transparent and liquid market? We may not have answers to all of these questions, but we think one thing's for certain. Secondaries are on the rise and the conditions are set for the trend to sustain. ♦

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