Spotlight on Secondaries: The rise of continuation funds

Continuation funds provide managers with a flexible option to retain valuable assets while navigating volatile markets, an attractive option in current market conditions. As the use of continuation funds continues to rise, it's important to understand the operational, regulatory and compliance aspects which need to be observed to ensure continuation funds are set up and run smoothly, as Matt Horton, Peter Blackburn and Scott Kraemer explain.

Commentators predicted an uptick in private markets fundraising as we entered 2025. This hasn't quite materialized as expected amid geopolitical uncertainty and policy flip-flopping, with the resulting market volatility leading many firms to adopt a 'wait-and-see' approach. This is likely more good news for the already booming secondaries market, which will continue to provide investment and liquidity options for GPs and LPs alike. We're also seeing a surge in the use of continuation funds across our client base.

Global deal volume in secondaries is expected to reach $175 billion this year, more than a 15% increase on last year's $152 billion, which was already a 40% leap from 2023's $109 billion, according to Lazard's Secondary Market Reports for 2023 and 2024.

Of the secondaries deal volume in 2024, GP-led secondaries comprised 48%, with the most common strategy by a large margin still buyouts. Making up 79% of GP-led deals, single and multi-asset continuation funds dominated in 2024, far out-pacing preferred equity and strip sale transactions. This is to be expected in a volatile market where secondaries investors are keen to buy – or maintain – stakes in mature assets with tried and test business models.

GPs use continuation funds to keep hold of either a trophy asset or a basket of portfolio companies that still have value creation potential through a separate structure. This allows them to avoid having to sell in a hostile market, while also providing liquidity options for LPs. Continuation funds also offer flexibility for GPs as the private markets landscape diversifies.

While continuation funds have traditionally been a tool for private equity managers, they are increasingly used in other asset classes, like private credit and infrastructure. Infrastructure's consistent performance, largely due to its index-linked revenue streams, is reflected in its increased allocation within institutional portfolios between 2020-2024, from 1.3% to 2.2%, making it 2024's best-performing asset class according to Preqin.

Indeed, fund managers holding onto high-performing assets is driving up GP-led secondaries activity, with Infrastructure Investor's LP Perspectives Study 2025 reporting that 84% of respondents said they have seen an increase in infrastructure continuation funds coming to market, and that they didn't expect this trend to slow, even as market conditions changed.

The evolution of continuation funds

Continuation funds are not new. In the past GP-led secondaries, known at the time as 'GP-led restructurings', were used by managers to transfer struggling assets out of funds and give them more time to improve their performance. This resulted in these structures gaining a stigma in the market and being seen as an indication of an underperforming GP.

Several pioneering managers then realised that these structures offered something that has been lacking in traditional limited partnership funds; options. In difficult dealmaking conditions, GPs have the option to keep hold of high-performing and/or high-potential assets led by management teams they know well. The conviction that GPs have in these deals is reflected by the fact that they often roll a significant portion of their carried interest into the continuation vehicle, aligning themselves with the continued success of the assets. It is an industry trend in single-asset continuation funds for GPs to roll in 100% of their carry, while in multi-asset deals this percentage might be between 75% and 85%.

As well as extending holding periods, continuation funds also solve another problem that GPs face towards the end of a fund's life; liquidity. At this stage, with the majority of capital drawn, options for portfolio companies that need additional capital are limited. A continuation fund specifically addresses this issue, as they can raise additional capital earmarked for that business. Traditionally in the latter stages of a fund, GPs have only one option to create liquidity for LPs, through distributions following the sale of assets.

In addition to the positives that these deals can provide GPs, they also offer LP benefits. LPs in the existing fund are given the choice of either taking liquidity by crystalising gains from the asset to date, or rolling into the continuation fund. By rolling, LPs gain continued exposure to assets they know well and reinforce their relationship with the GP. For these LPs there is often a status quo option, through the ability to maintain their existing economics in the new fund.

The third type of LP in this process are incoming LPs investing in the continuation vehicle for the first time, who get full visibility of the asset. Beginning a new GP relationship that has a shorter-term return time might fit their strategy. We have found among our clients, that for GPs this can be an effective way to attract new capital from an investor base it hasn't necessarily accessed before, and can create long lasting relationships with those new investors.

Challenges for GPs to consider

With a single GP being both the buyer and seller in these transactions, there is the potential for conflicts of interest to arise and GPs must be diligent about resolving these.

In launching a continuation fund a GP will typically need approval from the LP Advisory Committee of the existing fund. Engagement at an early stage is key, showing transparency and alignment with the interests of their LP base. Clearly communicating the financial and commercial logic for a transaction will greatly increase the chances of a deal succeeding.

Possibly the most contentious area to consider is pricing. Since GPs are on both sides of the transaction, they need to show their current LPs – whether exiting or rolling – and incoming LPs, that the price discovery process has been fair and transparent. This can be done through a range of strategies, from running an auction process to soliciting competing offers, to appointing a panel of independent experts to provide a fair valuation.

A checklist for GPs:

1. **Conflict of interest:**

Acting as both buyer and seller – GPs face a natural conflict as they are both selling assets from an existing fund and buying them back through the continuation fund, so they need to be transparent throughout the process.

Economic incentives – how bids are made, whether the GP receives economic incentives, and the treatment of carried interest can all create conflicts.

LP Advisory Committee (LPAC) – GPs need approval from the LPAC if there are amendments to the existing Limited Partnership Agreement (LPA).

2. **Structure and terms:**

Complex structure – different vehicles and capital deployment strategies require specialized skills.

Fees and carry – fees and carry structures need to reflect ongoing work required and incentivise eventual exits.

Pricing – determining a fair price for assets can be challenging and potentially contentious, especially in a volatile market where the bid-ask gap is wider.

Exit or reinvestment options – provide clear exit or reinvestment options for existing investors, and incentives for new investors to join.

Legal and tax Implications – understanding and communicating all legal and tax implications to investors makes for a smooth and successful transaction.

3. **Managerial duties:**

Fiduciary duties – GPs are subject to general fiduciary duties, as well as duties under the fund's governing documents (e.g., LPA, management agreement).

Ongoing management – the continuation fund will require ongoing management, and GPs need to ensure they have the expertise and resources to manage the fund effectively.

Experience – establishing a continuation fund is a complex process requiring a high level of expertise.

Administrative considerations:

Continuation funds require operational support to form the new structure, while a proportion of LPs need to be exited, with new ones onboarded. In addition to the due diligence and AML/KYC considerations this brings, perceived or potential conflicts of interest must be resolved, as well as agreeing carried interest calculations and fee structures. While GPs need to focus on sourcing new LPs for these vehicles, the attendant administration, reporting and compliance can be squared away by their current partner.

Continuation funds are now firmly established as a legitimate exit route for managers and LPs, as well as providing more options in a diversifying private markets landscape, not only for GPs but for different classifications of investors looking for access to private markets returns. They provide an attractive option for GPs to retain investments and still deliver liquidity to LPs amid volatile market conditions such as these.

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