

Demystifying Parallel Fund Structures:

Explaining the complexities
and benefits of parallel fund
structures

The Bright Alternative

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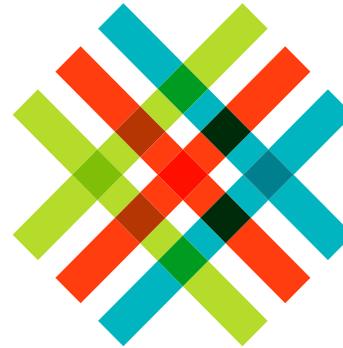


What are parallel fund structures?

In recent years, we've seen an increase in popularity towards parallel fund structures among private markets fund managers. These structures provide managers with the opportunity to raise more capital through multi-jurisdictional solutions.

Parallel fund structures are able to attract a larger pool of investors by offering bespoke solutions, adapted to investors' specific tax and risk profiles, while still investing in their chosen portfolio of assets.

In this guide, we will outline how parallel fund structures work, the benefits and operational complexities associated with running these structures, and how an operational provider like Aztec can help you to set up and administer parallel fund structures.



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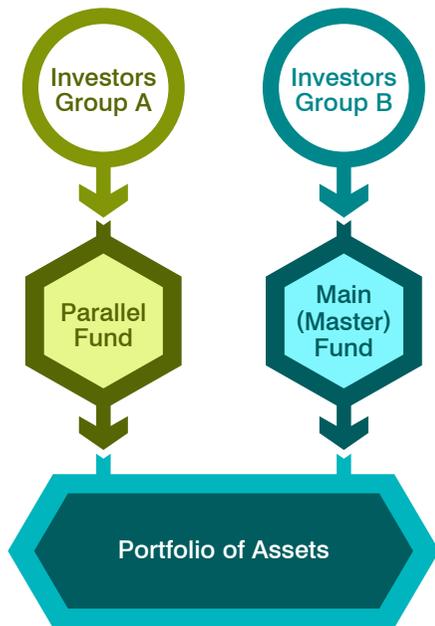
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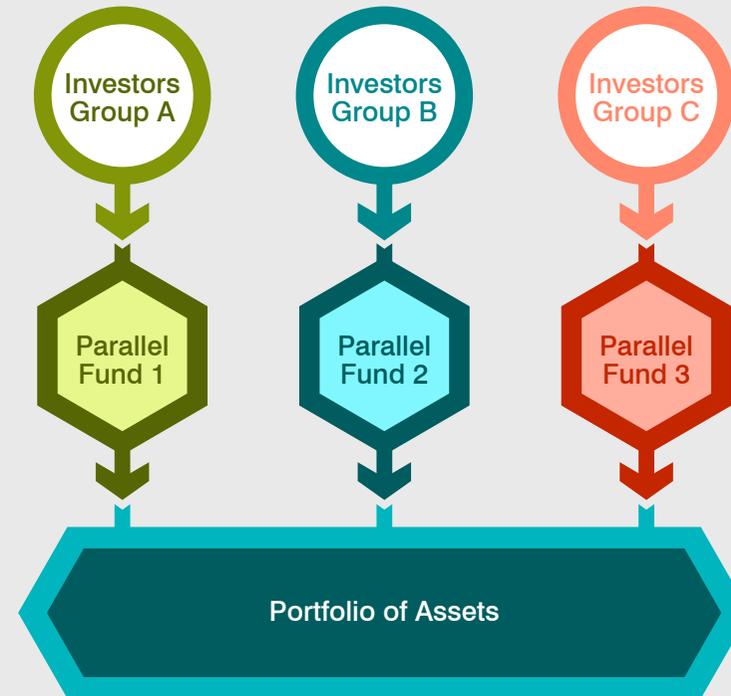


How parallel fund structures work

A parallel fund structure is typically made up of a fund which invests and divests alongside a main fund, into a common portfolio of assets. In the example below there is a main or 'master' fund alongside a supporting or 'parallel' fund - a structure more commonly termed in Luxembourg:



Some parallel fund structures are made up of multiple parallel funds operating without a definitive 'master' fund:



Ordinarily, parallel funds are structured as limited partnerships and share in the ownership of specified investments based on their committed capital amounts.



What are the benefits associated with parallel fund vehicles?

There are several features which make parallel fund structures appealing:

 **Simply put, more investors means the ability to raise more capital** 

1

Larger pool of investors

As two or more funds will be operating together, a larger pool of investors can be secured. In addition, in jurisdictions like Luxembourg, any restrictions on the number of limited partners that may apply can be overcome by establishing a parallel fund structure.

2

Greater capital investment

Simply put, more investors means the ability to raise more capital, which in turn enables the combined structure to create a larger and more diversified portfolio of investments.

3

Ability to service investors with different requirements

Parallel funds can be established in different jurisdictions, each with a common GP per location. Investors will therefore have their pick of the fund that best suits their jurisdictional preferences, while their tax goals and risk ratings will benefit from the centralised governance and compliance functions of the localised GP.

4

More choice for investors

By pooling investors into parallel funds based on similar requirements, certain financial and tax reporting can be more efficient and cost effective.



Explaining the operational complexities of a parallel fund structure

There are a number of complexities associated with the day-to-day management and administration of a parallel fund structure, which can be eased or eliminated at the setup stage. These include:

1

Equalisation

Depending on the total amount of capital commitments sought, the fund may commence operations and investment activity while the different parallel vehicles are still in the process of attracting new investors.

This can present a challenge, where capital needs to be contributed by investors and their specific parallel fund, based on an allocation which does not reflect the end-state allocation economics following a final close of the fund. Accordingly, once the final close has occurred, there will need to be equalisation of equity, loan capital and any 'true-up' interest across the parallel fund vehicles **and** the investors, to reflect the final ownership percentages based on the closing commitment amounts and contribution timing.

Care needs to be taken from an accounting perspective to ensure the equalisations are computed correctly and that cashflows to and from investors are processed in a timely manner, and are well documented through clear notices and any subsequent investor capital account reports.

Following the final close of the parallel fund, any assets and liabilities will also need to be equalised so that ownership reflects the final economic split between the parallel vehicles. Professional legal and tax advisors should be consulted to guide the process, particularly where complex corporate structuring has been implemented for asset ownership.

2

Individual but Aligned

The constitutional documentation of the parallel fund, whilst separate and distinct to each parallel vehicle, will need to align with each other when it comes to the investing and divesting strategy, the timing and mechanics for the distribution of proceeds, and the tenure of the funds. They should also have clear reference to the relationship between the parallel vehicles.

There can often be a form of umbrella agreement which also governs the operations of the parallel fund to ensure alignment, which requires additional oversight and compliance procedures from those responsible for corporate governance, for instance the Board of Directors, the Investment Advisor and the Administrator.



3

Impact of Exclusions

As noted previously, the base position is typically a pro-rata allocation of the Balance Sheet and P&L between the parallel vehicles in accordance with respective capital commitments. However, complexities can arise when, for example, one fund is excluded from a particular investment deal, or when some investors have clauses within their side letters that allow them exemptions from making certain investments and paying certain expenses, including management fees.

Whilst this complexity can arise within a more standard single structure fund, where parallel fund vehicles are in place the computation and tracking of ownership so that future cashflows are accurate, can be far more challenging.

4

Financial Reporting & Distribution

The challenges surrounding the production and distribution of financial data reporting can be compounded by the following:

1. Increase in the number of vehicles to be reported plus an aggregated set of financials
2. Co-ordination of audit requirements for multiple fund vehicles
3. Distribution of financial statements as well as investor reporting packs
4. Incorporating bespoke end-user requirements

Suitable accounting software is essential to achieving this.

5

Complexity and Volume of Operations

In general, administrative tasks will increase in volume as a result of the increase in the number of entities, jurisdictions and investors within the structure. For instance, more bank accounts may need to be maintained, distribution payments may need to be made to certain investors in a currency different to the functional currency of the parallel funds. Regulatory, tax and legal reporting may also differ across the funds.

Time differences across multi-jurisdictional structures may also impact real-time access to communications, information, and system access allowing for seamless processing. The control framework may also need to be adapted when it comes to deal activity, credit facility usage and fund operations, so that the total fund is always considered.



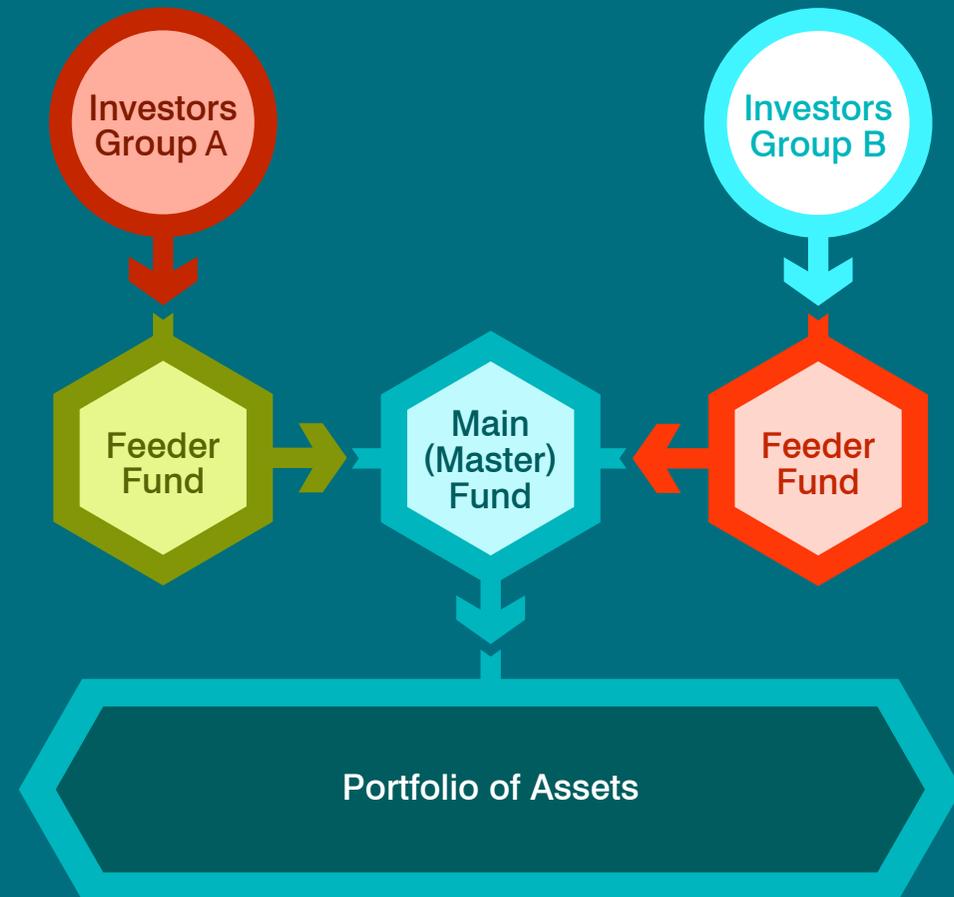
Alternative options to parallel fund structures

One alternative to the parallel fund structure is in the form of a master/feeder fund structure.

In this case, a separate vehicle called a 'feeder fund' is set up and pools its own investors. The feeder entity then acts as an 'investor' in its own right and makes an investment into a main fund known as the 'master fund', through which the various investment deals are captured. The feeder is therefore eligible to receive gains and losses from the master fund and, in turn, it passes these onto its investors.

In this structure, investments are made via the master fund only, hence there is only one trading entity for this purpose. The feeder fund can also be set up in a jurisdiction or manner that is favourable to the intended investor pool hence investors needs will still be met.

MASTER FEEDER / FUND STRUCTURE:





What do you need from an operations provider?



Partnering with a provider who is experienced in administering a variety of parallel fund structures with investment managers across the UK and Europe, is clearly preferable. Ideally, you'd partner with a provider who can help you review your legal documentation, identify and resolve areas which may cause you ongoing concern, and who can offer administrative solutions designed to make responding to your investor queries simpler, and quicker. All of which will give you peace of mind while taking the operational burden off your shoulders.

The right provider should have processes in place to manage multiple closes, equalisations and any complexities arising, AML gathering, FATCA/CRS assistance, and AIFMD reporting. You should also look for a provider which operates within a strong internal controls environment, designed to minimise and mitigate the risk of errors, and is regularly certified by an ISAE 3402 report, or equivalent.

HOW WE CAN HELP

The Aztec Group are specialists in Alternative Investment Funds and this has been our focus since we were founded in 2001. Our clients are industry-leading in their respective asset classes with complex fund structures being par for the course.

As a result, Parallel Funds Structures or Master Feeder structures are core to what we do and therefore our technology, processes and people are well equipped to turn 'complex' into 'common'.

To discover more about how Aztec can help you set up and manage your own parallel fund structures please reach out to our team, who are standing by to help with any questions.

Get in touch

If you would like to discuss any of the topics in this guide, as well as how the Aztec Group can support you, please talk to either your usual contact or get in touch with:



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